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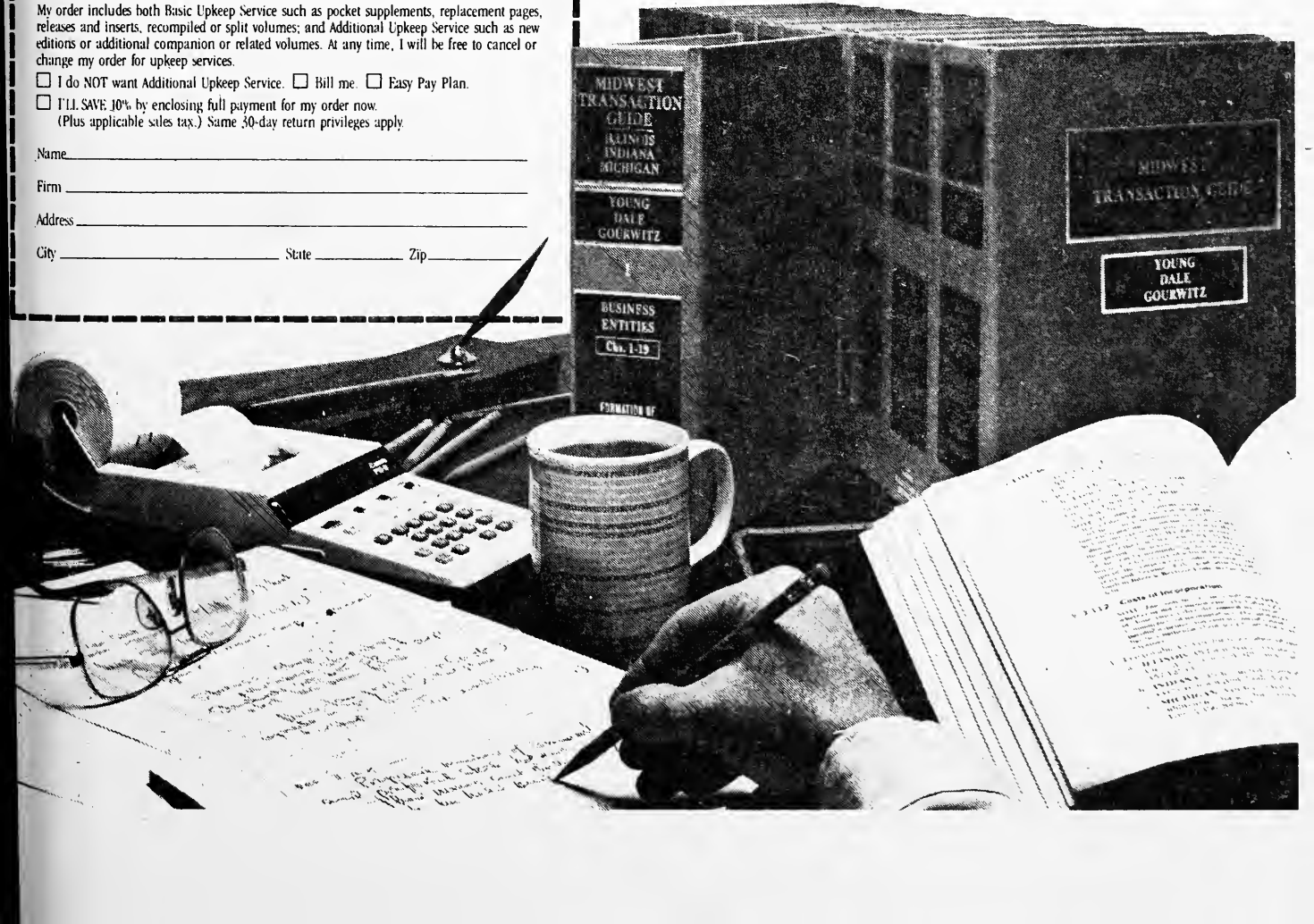

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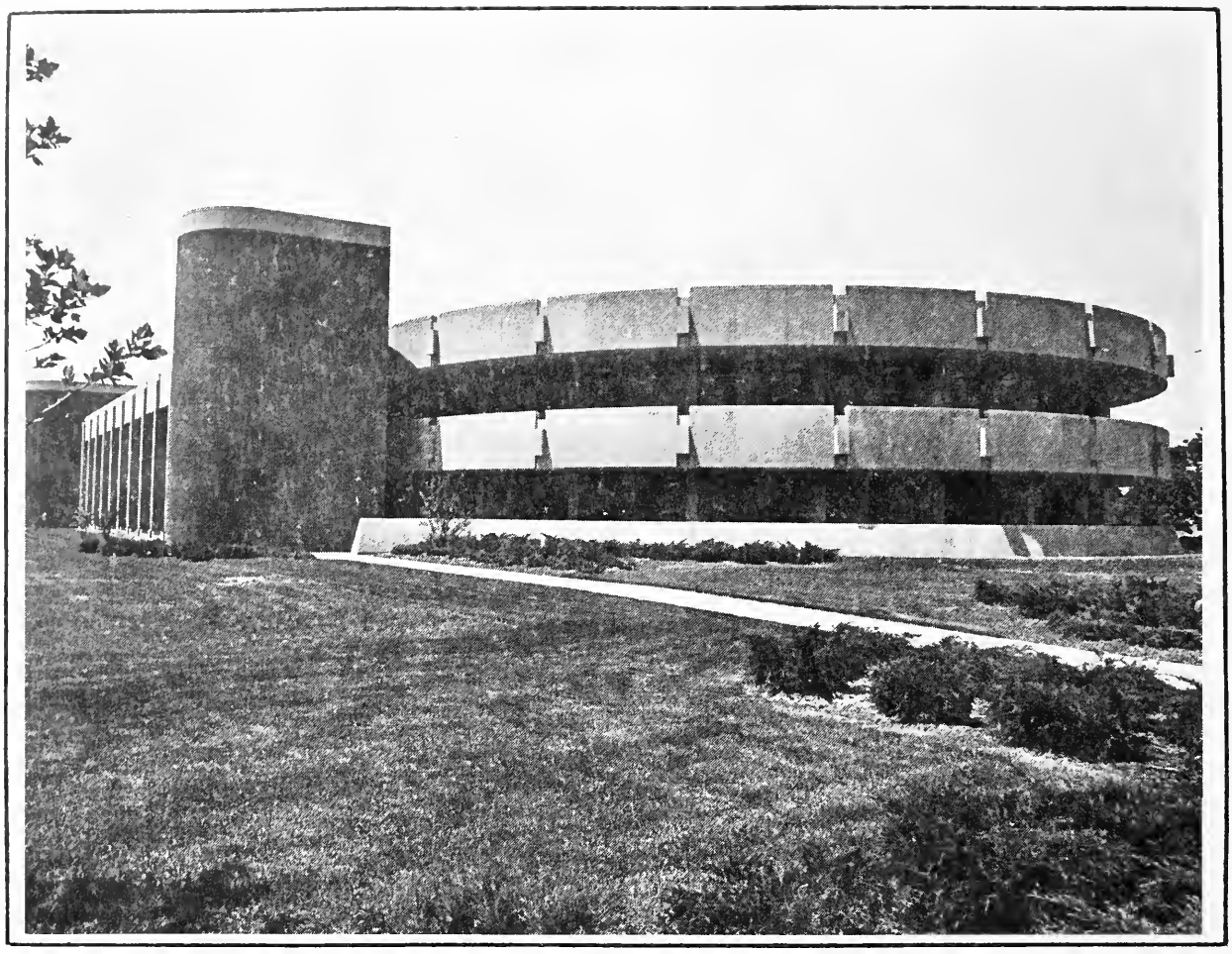

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Identification of Goods and Casualty to Identified Goods Under Article Two of the UCC

*Rhonda R. Rivera**

I. INTRODUCTION

Article two of the Uniform Commercial Code (UCC) introduces a new term into sales law: "identification."[1] Although the concept of identification is hardly new,[2] the use of the word as a term of art originated in the UCC.[3]

The purpose of the UCC is to bring uniformity and clarity to the law of commercial transactions.[4] Before and since its adoption, noted commentators have criticized the Code, claiming that neither uniformity nor clarity has resulted.[5] David Mellinkoff in his now famous critique *The Language of the Uniform Commercial Code*[6] singled out identification for a semantic attack.

> Some years ago, a smiling paranoiac offered to prove to our class in abnormal psychology that he was the true Christ

*Associate Professor of Law, Ohio State University Law School. J.D., Wayne State University Law School, 1967; M.P.A., Syracuse University, 1960; A.B., Douglas College, Rutgers University, 1959.

The author wishes to acknowledge the outstanding research assistance of Mary E. Jones.

[1]U.C.C. § 2-501(1)(a).

[2]*See* text accompanying notes 42-45 *infra*.

[3]The term "identification" is used in article 2 of the Code 43 times.

[4]U.C.C. § 1-102.

[5]*E.g.*, J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 24-33, 197-204 (1972); Goodkin, *The Ambiguous Statutory Machinery Pertaining to Fixtures Under the Uniform Commercial Code: Whether the New 9-313 Provision Effectively Eliminates Prior Criticism of the Old 9-313*, 27 ARK. L. REV. 482 (1973); Hudak & King, *Reforming and Rewriting Article Six of the UCC*, 81 COM. L.J. 284 (1976); Jackson & Peters, *Quest for Uncertainty: A Proposal for Flexible Resolution of Inherent Conflicts Between Article 2 and Article 9 of the Uniform Commercial Code*, 87 YALE L.J. 907 (1978); Skilton, *Some Comments on the Comments to the Uniform Commerical Code*, 1966 WIS. L. REV. 597.

[6]Mellinkoff, *The Language of the Uniform Commercial Code*, 77 YALE L.J. 185 (1967).

> and that Jesus was an imposter. "It's simple," he said. "I am the Christ because the Christ wouldn't lie to you!" The startling swiftness of that circular explanation is rivaled by the UCC on *identification*.[7]

Part of section 2-501, the main section of article two dealing with identification, provides: "In the absence of explicit agreement *identification* occurs (a) when the contract is made if it is for the sale of goods already existing and *identified*."[8] Mellinkoff caustically interprets these words as follows: "[W]hen you make a contract for the sale of existing goods, identification occurs when identification occurs, unless you explicitly agree that identification does not occur when it occurs."[9]

Aside from the circularity of the definition itself, there are at least two other major problems arising from section 2-501. The first problem is how and when fungible goods are identified to the contract. Section 2-501 does not answer this question explicitly, but an attempted explanation is found in comment 5 of section 2-501.[10] However, comment 5 must be read in connection with section 2-105(4)[11] which in turn is explained by comments 3 and 5[12] of that section. Comment 5 of section 2-105(4) refers the reader back to section 2-501. One returns to the point of origin still uncertain of the outcome.[13]

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[7] *Id.* at 191.

[8] U.C.C. § 2-501(1)(a) (emphasis added).

[9] Mellinkoff, *supra* note 6, at 192.

[10] U.C.C. § 2-501, Comment 5, provides:

> Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article.

[11] *Id.* § 2-105(4) provides:

> An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

[12] Comment 3 states: "Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale."

[13] Mellinkoff commented on this type of definitional problem.

> Some of the things the UCC calls "definitions" have hardly any meaning—some no meaning at all—because they are circular. They define a word with the same word, or with a variation of the word so close that you return to the starting point almost unscathed by information. Sometimes the circuit is short and easy to trace; sometimes the circuit winds over hill and dale before sneaking back on itself.

Mellinkoff, *supra* note 6, at 191.

The second problem lies in the fact that the drafters of the Code sometimes forgot that they had sanctioned a new term. They carelessly inserted old-fashioned synonyms for identification in many of the comments. The words "appropriation," "specific," and "particular" appear in places where "identification" and "identified" should logically be used.[14] The resulting confusion has led to use of the terms "appropriation" and "identification" interchangeably in interpreting Code provisions.[15] Moreover, in section 2-613 of the Code, which is entitled "Casualty to Identified Goods," the use of the term "identified" in the title is inappropriate and misleading. The key to section 2-613 is not whether the goods are identified but whether they are commercially irreplaceable.

Despite a statement by the Indiana Court of Appeals that "[i]dentification is of limited importance under the Code,"[16] identification is, in fact, a very important concept. A number of legal consequences depend upon identification. Title cannot pass until goods are identified.[17] Identification gives the buyer a "special property and an insurable interest" in the goods.[18] Moreover, once goods are identified a buyer may recover them upon the seller's insolvency[19] or upon default or repudiation;[20] he has a limited right of replevin,[21] and he can assert such a right against the seller's unsecured creditors.[22] Identification means certain rights to the seller as well. Under some conditions, the seller may, after identification, pursue an action for the price[23] and resell.[24] Moreover, identification is often a prerequisite for asserting security interest rights under article 9.[25]

Various definitions of identification suggested in the past have been unsatisfactory. One technical definition, that identification is "an intent to identify particular goods and some overt act

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[14]*E.g.*, U.C.C. § 2-105, Comment 3; *id.* § 2-401, Comment 4; *id.* § 2-513, Comment 2; *id.* § 2-606, Comments 1, 2; *id.* § 2-615, Comments 1, 5, 9.

[15]*See, e.g.*, Crown Iron Works Co. v. Commissioner of Taxation, 298 Minn. 559, 214 N.W.2d 462 (1974); Miss Celebrity, Inc. v. Dartmouth Finishing Co., 15 U.C.C. REP. SERV. 764 (1974).

[16]First Nat'l Bank v. Smoker, 153 Ind. App. 71, 86, 286 N.E.2d 203, 212 (1972).

[17]U.C.C. § 2-401(1).

[18]*Id.* § 2-501(1).

[19]*Id.* § 2-502.

[20]*Id.* § 2-711(2)(a).

[21]*Id.* § 2-716(3).

[22]*Id.* § 2-402(1).

[23]*Id.* § 2-709(1)(b), (2).

[24]*Id.* § 2-706(2).

[25]National Compressor Corp. v. Carrow, 417 F.2d 97, 101 (8th Cir. 1969); Draper v. Minneapolis-Moline, Inc., 100 Ill. App. 2d 324, 327-28, 241 N.E.2d 342, 344-45 (1968); Dolan, *The Uniform Commerical Code and the Concept of Possession in the Marketing and Financing of Goods*, 56 TEX. L. REV. 1147 (1978).

manifesting that intent,"[26] again gives rise to troublesome circularity by use of the word defined in the definition. Identification has also been defined as the process by which goods are "particularized or designated as the goods to which the contract refers."[27] This definition, though workable, is unnecessarily imprecise. The contract could apply to goods other than those sought to be identified. Identification should be defined to *specify the goods to which the contract refers so that the contract can apply to no others*.[28] This definitional phrase is consistent with the various Code usages and with historical developments in sales law. This Article will develop the meaning of identification historically, examine its current usage in cases decided under the UCC, and delineate how the concept of identification affects various sections of article two.

Identification of goods so that an insurable interest arises is explained in section 2-501:

> (1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are non-conforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs
>
> (a) when the contract is made if it is for the sale of goods already existing and identified;
>
> (b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;
>
> (c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting whichever is longer.
>
> (2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains

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[26]2 R. ANDERSON, ANDERSON ON THE UNIFORM COMMERICAL CODE § 2-501:4, at 61 (2d ed. 1971).

[27]Stockton, *An Analysis of Insurable Interest under Article Two of the Uniform Commercial Code*, 17 VAND. L. REV. 815, 828 (1964).

[28]A seller may unilaterally identify goods to a contract. U.C.C. § 2-501(1)(b). If the seller tenders nonconforming goods which he has erroneously identified, the buyer may accept or reject the goods in whole or in part. *Id.* § 2-601.

in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.[29]

II. HISTORY OF SECTION 2-501

The above version of section 2-501, with minimal and insignificant changes, is enacted in forty-nine states.[30] Prior to its enactment in

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[29]U.C.C. § 2-501, Comments 1-5, provide:

1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement".

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of paragraphs (a), (b) and (c) are displaced—as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article.

[30]1A UNIFORM LAWS ANNOTATED: UNIFORM COMMERCIAL CODE iii (West 1976).

many states and contemporaneous with its enactment in others, the UCC went through numerous drafts and revisions.[31] The Proposed Final Draft of the UCC published in the spring of 1950 was much like the current law.[32] At that point, the circular definition was firmly in place. The immediately preceding draft was significantly different, however. Section 2-501 in the May 1949 draft of the UCC was entitled "Manner of Appropriation." Appropriation was defined as follows: "Existing goods are appropriated to a contract for sale by their identification as goods to which the contract refers." The effects of appropriation were set out in a separate and subsequently deleted section.[33]

The 1949 draft, which did not define the term by a repetition of the term itself, was clear. A standard dictionary definition could then give substance to the legal term of art "appropriation." For example, the *Random House Dictionary of the English Language* defines "identify" as "to recognize or establish as being a particular person or thing."[34] Thus, one appropriates goods to a contract by identifying them, that is, by establishing which particular things were involved in the contract in order that the goods referred to in the contract were identical to those appropriated. Or, according to the definition suggested earlier, one appropriates goods by so clearly specifying the goods to which the contract refers that the contract can apply to no others.

The word "appropriation" as used in the 1949 draft came directly from the Uniform Sales Act,[35] the statutory precursor of the UCC. Under the Uniform Sales Act, goods had to be "ascertained"[36] before title could pass. Goods were "ascertained" when they were "appropriated" to the contract. Appropriation to the contract meant some action was taken that made certain, definite, and specific the

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[31]*Id.*

[32]ALI-NCCUSL, UNIFORM COMMERCIAL CODE (proposed final draft 1950). Section 2-501 as currently written was in the same form in the 1957 Official Text. The 1956 recommendations inserted the words "special property" found in the present text. The authors commented that the "reference to the buyer's 'special property' was inserted in subsection (1) to conform to changes in § 1-201(37) and 2-401." *Id.*, Comment. The first supplement to the 1952 Official Draft added the current subsection (3) of 2-501. U.C.C. (Supp. 1, 1952 version).

[33]U.C.C. § 2-502 (1949 draft).

[34]THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 707 (unabr. ed. 1973).

[35]UNIFORM SALES ACT § 19 (1906) (superseded by U.C.C.). The term "identified to the contract" as used in U.C.C. § 2-501 is generally considered the equivalent to the term "appropriated to the contract" as used in the Uniform Sales Act. 67 AM. JUR. 2d *Sales* § 234, at 362 n.83 (1973).

[36]UNIFORM SALES ACT § 17 (1906) (superseded by U.C.C.).

goods to which the contract referred.[37] The courts construing the Uniform Sales Act required an unconditional appropriation.[38]

The word "appropriation" as used in the Uniform Sales Act had a strong common law foundation. It meant, for example, selecting "the article . . . to supply in performance of [the] contract,"[39] or agreement that "a certain article shall be delivered in pursuance of the contract,"[40] or that there is a bargain "with respect to a specific article."[41] There are numerous pre-Uniform Sales Act American cases and many English cases as well that make it abundantly clear that identification, ascertainment, and appropriation all refer to the same action: to specify the goods to which the contract refers so clearly that the contract can apply to no others.[42]

One of the difficulties in comparing UCC cases, Uniform Sales Act cases, and common law cases dealing with appropriation-identification is that the consequences of an identical act have changed over the years. Under the Uniform Sales Act and the common law, the actual, if mystical, passage of title was all important and "ascertainment-appropriation" was the key.[43] The Code changed that legal concept dramatically. Title passage between the vendor and vendee became incidental rather than crucial.[44] Major rights, such as

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[37]I. MARIASH, A TREATISE ON THE LAW OF SALES 343-61 (1930); 2 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS §§ 273a-278 (rev. ed. 1948).

[38]*In re* Lincoln Indus., 166 F. Supp. 240 (W.D. Va. 1958); Wills v. Investors' Bankstocks Corp., 257 N.Y. 451, 178 N.E. 755, 251 N.Y.S. 69 (1931). *See* Henry Glass & Co. v. Misroch, 239 N.Y. 475, 147 N.E. 71 (1925); Lamborn v. Seggerman Bros., 240 N.Y. 118, 147 N.E. 607 (1925); Proctor & Gamble Co. v. Peters, White & Co., 233 N.Y. 97, 134 N.E. 849, 193 N.Y.S. 61 (1922); Beals v. Hirsch, 214 A.D. 86, 211 N.Y.S. 293 (1925); Taylor v. Kurzrok, 214 A.D. 308, 212 N.Y.S. 133 (1925); Boiko & Co. v. Atlantic Woolen Mills Co., 195 A.D. 207, 186 N.Y.S. 624 (1921), *aff'd*, 234 N.Y. 583, 138 N.E. 455, 198 N.Y.S. 61 (1922); UNIFORM SALES ACT § 19, Rule 4(2) (1906) (superseded by U.C.C.); 2 S. WILLISTON, *supra* note 37, § 273a.

[39]Wait v. Baker, 154 Eng. Rep. 380, 383 (Ex. 1848).

[40]*Id.*

[41]*Id.* at 384. *See also* Furby v. Hoey, [1947] 1 All E.R. 236, 238 (K.B.).

[42]*See, e.g.*, The Elgee Cotton Cases, 89 U.S. (22 Wall.) 180 (1874); Kimberly v. Patchin, 19 N.Y. 330 (1859); Seath v. Moore, 55 L.J.P.C. 54 (1886). *See* J. BENJAMIN, A TREATISE ON THE LAW OF SALE OF PERSONAL PROPERTY 300, 317, 327 (8th ed. 1950); D. BOWEN, ELEMENTS OF THE LAW RELATING TO VENDORS AND PURCHASERS 176-77 (2d ed. 1929); M. CHALMERS, SALE OF GOODS ACT 1893 §§ 16, 18 (Rule 5(1)), at 62 (14th ed. 1963); 2 S. WILLISTON, *supra* note 37, § 273a.

[43]Rosen v. Garston, 319 Mass. 390, 66 N.E.2d 29 (1946); Mitchell v. Le Clair, 165 Mass. 308, 43 N.E. 117 (1896); Pierce Oil Co. v. Carroll, 277 S.W. 220 (Tex. Civ. App. 1925); Rohde v. Thwaites, 108 Eng. Rep. 495 (K.B. 1827); Heilbutt v. Hickson, L.R. 7 C.P. 438, 449-50 (1872); UNIFORM SALES ACT §§ 17-19 (1906) (superseded by U.C.C.); K. LLEWELLYN, CASES AND MATERIALS ON THE LAW OF SALES 561, 571-73, 577-81 (1930); I. MARIASH, *supra* note 37, §§ 343-61 (1930).

[44]The Comment to U.C.C. § 2-101 stipulates: "The legal consequences are stated as following directly from the contract and action taken under it without resorting to the

risk of loss, hinged on clear-cut objective actions by the parties rather than on title passage. Identification as used in the Code became the key action.[45]

III. IDENTIFICATION AND THE FUNGIBLE BULK PROBLEM

Section 2-501 specifically provides that identification "can be made at any time and in any manner explicitly agreed to by the parties." This approach is in keeping with general Code policy to encourage parties to make their own agreements. The Code is available to supply the terms and procedures only if the parties have ignored, overlooked, or avoided them. In the case of identification, when the parties fail to state how and when identification occurs, one turns to section 2-501.

Assume a contract for goods that are already in existence, that is, they do not have to be manufactured or grown. The provision in section 2-501(1) that identification occurs "when the contract is made if it is for the sale of goods already existing and identified," offers little enlightenment. There are two possible situations. Consider the case in which the goods involved are clearly unique.[46] In that case, if the contract description is sufficient to describe the goods, no more is needed and identification occurs at the time the contract is made. In the second case, assume the goods are not unique, but standardized.

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idea of when property or title passed or was to pass as being the determining factor." Nordstrom states: "The Code's approach can be summarized thus: specific problems are identified and solutions to those problems are established without concern as to who has title or the time a title might have passed from seller to buyer." R. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 125, at 375 (1970). Hawkland says,

> [I]n the U.C.C. there are usually specific provisions with respect to the various rights and duties of the buyer and seller, such as risk of loss (2-509 and 2-510), insurable interest (2-501), . . . and often these provisions are not predicated upon ownership considerations. Consequently, the "title" concept is relatively unimportant under the U.C.C.

W. HAWKLAND, SALES AND BULK SALES 91 (1955).

[45] *See* U.C.C. § 2-401, Comments 2, 4; *id.* §§ 2-501(2), 2-509, 2-510.

[46] At common law, unique meant irreplaceable and specific performance was an appropriate remedy. U.C.C. § 2-716, Comment 2. *See* UNIFORM SALES ACT §§ 68, 76 (1906) (superseded by U.C.C.); 5A A. CORBIN, CONTRACTS § 1142, at 117-18 (1964) (Specific performance is granted when "the subject matter of the contract is unique in character and cannot be duplicated or because the obtaining of a substantial equivalent involves difficulty, delay, and inconvenience."); RESTATEMENT (FIRST) OF CONTRACTS § 361, Comment g (1932) ("A chattel may be unique in kind, quality, or personal association, or so nearly so that the purchase of its equivalent elsewhere is impracticable."); 3 S. WILLISTON, *supra* note 32, § 602 ("Where, however, a chattel is unique or not purchasable in the market, specific performance has been granted. . . . In some cases, . . . the importance of the goods in the particular case, and the difficulty of acquiring them, except through the defendant, will induce the court to decree specific performance."). *See also* Morris v. Sparrow, 225 Ark. 1019, 287 S.W.2d 583 (1956); McCallister v. Patton, 214 Ark. 293, 215 S.W.2d 701 (1948); Fortner v. Wilson, 202 Okla. 563, 216 P.2d 299 (1950).

If the contract provided for the sale of 1,000 widgets, the goods might be "existing" under section 2-501(1)(a), but they are not sufficiently "identified" for identification to have occurred. Two actions must take place if identification is to occur at the time the contract is made. First, the description must be made more specific, for example, "1,000 widgets in boxes number 1 through number 100 in our warehouse in Podunk, Ohio," and second, sometime prior to the making of the contract, boxes containing 1,000 widgets must have been designated number 1 through 100. Thus, when the contract is made the goods would then be *already* existing and identified. To substitute the clearer definition suggested by this Article, the goods are already existing and are so clearly specified as the goods to which the contract refers that the contract can apply to no others. A clear case of goods already existing and identified can be found in *Draper v. Minneapolis-Moline, Inc.*,[47] in which the court ruled that there was sufficient identification when the seller pointed to a tractor on his premises and told the buyer it was his in reference to a contract into which the two parties had entered.[48] In *Richards & Associates, Inc. v. Tennessee Forging Steel Corp.*,[49] 268 tons of steel product which "had been prepared, set aside, and tagged" were also sufficiently identified to the contract.[50]

Suppose next that the contract had provided for the sale of 1,000 widgets located in our warehouse in Podunk, Ohio and that at the time of the making of the contract there were only 1,000 widgets in the warehouse. Under section 2-501(1)(a), which deals with identification contemporaneous with the making of the contract, the existing goods must either be unique or have been designated, segregated, or marked prior to the making of the contract. Because the contract can apply only to those particular or specific goods, identification is complete upon the making of the contract.

The next, and most troublesome, example is a contract which speaks of 1,000 widgets in our warehouse in Podunk, Ohio, when there are, in fact, 10,000 widgets in that warehouse. The likely assumption is that there is not a sufficient identification. Since we do not know exactly which 1,000 widgets are the subject of the contract, there can be no specific identification. It would be well to point out at this juncture that the Code policy favors early identification in moments of doubt.[51] What is bothersome here is that it is not entirely clear which of the 10,000 widgets are covered by the

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[47]100 Ill. App. 2d 324, 241 N.E.2d 342 (1968).

[48]*Id.* at 327-28, 241 N.E.2d at 344.

[49]24 U.C.C. Rep. Serv. 326 (E.D. Tenn. 1978).

[50]*Id.* at 330.

[51]U.C.C. § 2-501, Comment 2.

contract. If we conclude that the widgets are not identified, then the contract is one for the sale of future goods and falls under section 2-501(1)(b).[52] In a sale of future goods, identification does not occur until the seller ships, marks, or otherwise designates them as the goods to which the contract refers.[53]

It is arguable, however, that what is being sold in this example is an undivided share of all the widgets in the Podunk warehouse. In other words, if widgets are fungible,[54] then the sale of 1,000 is an undivided share in an identified fungible bulk of 10,000 widgets located in our warehouse in Podunk, Ohio. Subsection (3) of section 2-105 permits a sale of a "part interest in existing identified goods" and subsection (4) of section 2-105 provides that an "undivided share in an identified bulk of fungible goods is sufficiently identified to be sold." Comment 5 of section 2-501 explains further that "[u]ndivided shares in an identified fungible bulk . . . can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough . . . to effect an identification if there is no explicit agreement otherwise."

Regarding the primary issue, whether widgets are fungible, the UCC definition of fungible is broad enough to encompass any standardized good. Section 1-201(17) defines fungible goods as "goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit." One court has held, for example, that wooden dowels are fungible.[55]

The next issue that arises is the definition of an "identified fungible bulk." Even if we read the word "identified" to mean so clearly specified that the contract can apply to no other, specifying 1,000 widgets in a certain warehouse seems to establish the existence of an identified fungible bulk. By specifying the warehouse

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[52]Section 2-105(2) specifies that "[g]oods must be both existing and identified before any interest in them can pass." If goods are not both existing and identified, they are "future" goods and a present sale cannot be accomplished.

[53]Martin Marietta Corp. v. New Jersey Nat'l Bank, 25 U.C.C. REP. SERV. 1458 (D.N.J. 1979); *see* U.C.C. § 2-105(2).

[54]U.C.C. § 1-201(17) provides:

> "Fungible" with respect to goods or securities means goods or securities of which any unit is by nature or usage of trade, the equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this Act to the extent that under a particular agreement or document unlike units are treated as equivalents.

[55]Valley Forge Flag Co. v. New York Dowel & Moulding Import Co., 395 N.Y.S.2d 138, 139 (1977). This ruling rested upon the finding by the court that a dowel was a round wooden rod or stick requiring no particular type of wood, and that the defendant admitted that he could have replaced the dowels by purchasing them on the open market. The dowels were apparently interchangeable and replaceable. *See* text accompanying notes 74-77 *infra*.

one identifies the bulk. If there are thousands of other widgets in the warehouse, it is true that we cannot know exactly which widgets were sold without a more precise description. But section 2-105(4) provides that one can sell "[a]n undivided share in an identified bulk of fungible goods . . . although the quantity of the bulk is not determined," and that "[a]ny agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common." Therefore, when one sells a certain quantity of a fungible good from a clearly specified bulk of goods, for example, 1,000 widgets from our warehouse in Podunk, Ohio, one is selling an undivided share in an identified fungible bulk.

The term "undivided share" is applied to interests in property either real or personal. Frequently, the term is used in connection with forms of concurrent ownership—joint tenancy, tenancy in common, and tenancy by the entirety. All of these forms of ownership require that each tenant have an equal right to possess the whole. Cribbett in *Principles of the Law of Property* speaks of "co-owners [who] have simultaneous interests in every portion of the thing, but no separate interest in any particular portion of it."[56] Both sections 2-105 and 2-501 apply this terminology to the sale of goods. The parties to the sale who have an "undivided share in an identified bulk of fungible goods" have, therefore, simultaneous interests in the whole bulk and no separate interest in any particular portion of it. They have a claim, determined by the extent of their share, to every part of the whole and not to a particular portion that has been specified or particularized. When one sells an undivided share in an identified fungible bulk, one is selling a portion of a bulk of fungible goods—the bulk in question so clearly designated that the contract can apply to no other. The new owner has a simultaneous interest in the whole bulk but no separate interest in any specific portion of it.

Given the policy in favor of early identification coupled with the Code sections which provide for ownership in common,[57] the sale of 1,000 widgets from a warehouse in Podunk, Ohio, when there are 10,000 widgets in the warehouse, should sufficiently identify the goods to allow a present sale.

Section 2-501(1)(a) provides for identification simultaneous with the making of the contract so that a present sale is accomplished. Thus, identification occurs when the words of the contract so clearly specify the goods to which the contract refers that the contract can

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[56]J. CRIBBETT, PRINCIPLES OF THE LAW OF PROPERTY 94 (2d ed. 1975).

[57]*See* U.C.C. § 2-105(3), (4); *id.* § 2-501, Comment 5.

apply to no others. This result can be accomplished by describing three types of goods: (1) Unique, or commercially irreplaceable, goods; (2) goods already separated, marked or designated; and (3) goods within a clearly specified fungible bulk.

IV. Relation of Identification to Section 2-613

One of the most important consequences of identification is that it shapes the rights of the buyer and seller when non-negligent casualty occurs to the goods.

Consider section 2-613, labeled *"Casualty to Identified Goods"*:

> Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (Section 2-324) then
>
> (a) if the loss is total the contract is avoided; and
>
> (b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

This section allows avoidance of the contract entirely if the loss of the goods is total, and either avoidance or acceptance with price allowance at the buyer's option, if the loss is only partial. The kind of goods to which section 2-613 applies is far from clear. If one reads the section carefully and avoids the misleading title, the section does not apply to all goods identified to the contract but only to goods "[w]here the contract requires for its performance goods identified when the contract is made."[58] What does that mean? Comment 1 to section 2-613 states that the section applies to goods "whose continued existence is presupposed by the agreement." What this section was designed to cover becomes marginally clearer when one discovers that in the 1949 draft of the Code, section 2-613 applied "[w]here the contract relates to identified goods which are irreplaceable or are treated by the parties as unique for purposes of

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[58]It has been suggested that "identified" is an imprecise term here: "Perhaps the closest synonym for 'identified' in this section [2-613] is 'specified.' If the purchased goods are specified by the contract (as that one refrigerator and no other, or that machine to be built and no other), the first condition of section 2-613 has been met." R. Nordstrom, *supra* note 44, § 108, at 327 (1970). *See* National Compressor Corp. v. Carrow, 417 F.2d 97 (8th Cir. 1969).

the contract."[59] In the 1956 recommendations, the current phraseology is substituted.[60] Comment 1 to section 2-613, however, has remained the same under both texts, leading to the conclusion that the drafters thought that the new text meant the same thing as the old.

The conclusion to be drawn from a reading of the text and history of both sections is that the section requires two criteria. First, the goods must be identified. Second, the goods must be unique or irreplaceable. Section 2-613 is designed to cover destruction of goods under contract before the risk of loss has passed to the buyer. The central issue is whether the casualty loss will excuse the seller from performance; and in this respect is comparable to the common law doctrine of "impossibility"—if the subject matter of the contract is destroyed, the contract is void because it is "impossible" to perform.[61] If unique or irreplaceable goods are destroyed, the seller is excused for impossiblity.[62] That is not the same as saying that if identified goods are destroyed the seller is excused. All unique goods are identified but not all identified goods are unique.[63] Thus, the title to

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[59]U.C.C. § 2-613 (May 1949 draft).

[60]ALI, 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE (1957).

[61]Taylor v. Caldwell, 122 Eng. Rep. 309 (Q.B. 1863). Numerous American courts adopted the common law doctrine and excused performance when it became impossible to perform. *E.g.*, Columbus Ry. Power & Light Co. v. City of Columbus, 249 U.S. 399 (1919); Krause v. Board of Trustees, 162 Ind. 278, 70 N.E. 264 (1904); Juett v. Cincinnati N.O. & T.P.R. Co., 245 Ky. 379, 53 S.W.2d 551 (1932); Elsemore v. Inhabitants, 137 Me. 243, 18 A.2d 692 (1941); Ellis Gray Milling Co. v. Sheppard, 359 Mo. 505, 222 S.W.2d 742 (1949); Matousek v. Galligan, 104 Neb. 731, 178 N.W. 510 (1920); Gouled v. Holwitz, 95 N.J. 277, 113 A.2d 323 (1921); International Paper Co. v. Rockefeller, 161 A.D. 180, 146 N.Y.S. 371 (1914). *See generally* Schlegel, *Of Nuts, and Ships, and Sealing Wax, Suez, and Frustrating Things: The Doctrine of Impossibility of Performance*, 23 RUTGERS L. REV. 419 (1969); Annot., 12 A.L.R. 1273, 1278 (1921).

[62]*E.g.*, Stewart v. Stone, 127 N.Y. 500, 28 N.E. 595 (1891), wherein the court stated:

> By the contract now under consideration, the cheese and butter were to be manufactured at this factory, and to be made from the milk furnished by the patrons. . . . The existence of that particular factory was terminated by its destruction, and the loss with it of the manufactured product . . . rendered it impossible for the defendant to further proceed with the performance of his contract . . . . And, as the nature of the agreement was such that it must be deemed to have been contemplated by the parties to it that the articles to be manufactured should be made *only* from the materials furnished by the patrons and at the factory referred to, there was necessarily an implied condition so qualifying the defendant's undertaking as to relieve him from performance rendered impossible without his fault.

Id. at 507-08, 28 N.E. 596-97 (emphasis added).

[63]Pittenger Equip. Co. v. Timber Structures, 189 Or. 1, 217 P.2d 770 (1950). The Oregon Supreme Court construed Uniform Sales Act § 68 as follows: "Goods that are 'specified or ascertained' may in an occasional instance be unique, but they may also be readily available in the market." *Id.* at 22, 217 P.2d at 779.

section 2-613, "Casualty to Identified Goods," is inappropriate and misleading. The section would be better titled "Casualty to Goods."

Under the 1949 draft of section 2-613, the goods had to be irreplaceable or treated by the parties as unique for the purpose of the contract.[64] It could be argued that the second phrase would allow identification by itself to create unique goods. For example, the marking of the 1,000 widgets with numbers 1 through 1,000 would, by itself, make them unique widgets. The 1956 change removes this possibility by specifying that the contract must require identified goods, but this change still leaves the text open to interpretation. If the Code drafters meant unique goods, it would have been helpful if they had said unique goods. A section so worded need not have been circumscribed by the narrow common law definition of uniqueness. It could have been broadened to include the concept of "commercial feasibility of replacement."[65] If one interprets section 2-613 to apply to all identified goods, identification becomes synonymous with uniqueness. By that interpretation, no other goods, even those exactly the same as the identified goods, will ever satisfy the contract.

Suppose that the contract calls for the sale of 1,000 widgets in our warehouse in Podunk, Ohio, that there are only 1,000 widgets in the warehouse, and that the warehouse and the 1,000 widgets are destroyed. Under the criterion found in the 1949 draft, one would have to find either that the goods were irreplaceable, or that the parties treated them as unique for the purposes of the contract. Since widgets are fungible, it is likely that they are replaceable in the market, but the parties to the contract could have intended to treat them as unique by specifying the only widgets located in a specific warehouse. In other words, the "continued existence" of those particular widgets in that specific warehouse was "presupposed by the agreement."[66] To fall within the ambit of the current version

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[64]U.C.C. § 2-613 (1949 draft).

[65]U.C.C. § 2-716, Comment 2. *See* Kaiser Trading Co. v. Associated Metals & Minerals Corp., 321 F. Supp. 923 (N.D. Cal. 1970), *aff'd*, 443 F.2d 1364 (9th Cir. 1971); *cf.* Poltorak v. Jackson Chevrolet Co., 322 Mass. 699, 79 N.E.2d 285 (1948):

> It is settled in this Commonwealth that specific performance of contracts [will be granted] for the sale of chattels where the buyer shows that he is unable by reason of the nature of the subject, the conditions of the market, or other circumstances, to procure an article substantially similar to the one which he contracted to buy, or that the delay, expense and difficulties incidental to procuring such an article will entail serious inconvenience, loss of [*sic*] hardship, or that he stands in such a relation to the article that manifest justice will not be done unless performance is decreed.

Id. at 700, 79 N.E.2d at 285-86.

[66]U.C.C. § 2-613, Comment 1. In Israel v. Luckenbach S.S. Co., 6 F.2d 996 (2d Cir. 1925), the court stated:

> Where parties enter into a contract on the assumption that some par-

of section 2-613, it would have to be shown that the contract required for its performance goods identified to the contract when the contract was made. A contract that requires certain goods for its performance also presupposes the continued existence of the goods.[67]

If it can be shown that the parties to the contract identified those 1,000 widgets in that specific warehouse because the contract required such a specificity, the seller is excused. It is traditional to treat goods so specifically described in terms of location as unique.[68] If goods are treated as unique, their destruction is an excuse for non-performance.[69] In the famous case of *Howell v. Coupland*,[70] the court excused a farmer from a contract specifying that the crop was

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> ticular thing essential to its performance will continue to exist and be available for that purpose, . . . if before the time for performance and without the default of either party the particular thing ceases to exist or be available for the purpose, the contract shall be dissolved and the parties excused from performing it.

Id. at 997. *See also* Gibbs v. Hersman, 73 Cal. App. 732, 239 P. 350 (1935); Howell v. Coupland, 46 L.J.Q.B. 147 (1876); Taylor v. Caldwell, 122 Eng. Rep. 309 (Q.B. 1863); RESTATEMENT (FIRST) OF CONTRACTS § 460, Comment d.

[67]As noted by Corbin:

> There are many contracts in which the performance of one of the promises will be absolutely impossible in case of the destruction or non-existence of some specific thing. The parties . . . assume the thing's continued existence and express no intention as to what shall be done in case the things is destroyed or non-existent.

6 A. CORBIN, *supra* note 46, § 1337, at 388.

[68]In Holroyd v. Marshall, 33 L.J.Ch. 193 (1862), the court stated in dictum that "a contract to sell the 500 chests of a particular kind of tea which are now in my warehouse in Gloucester, was a contract relating to specific property, and which would be specifically performed." *Id.* at 196. *See also* Henry Heide, Inc. v. Atlantic Mut. Ins. Co., 80 Misc. 2d 485, 363 N.Y.S.2d 515 (1975) (sugar identified by its location in a particular warehouse in an action concerning the risk of loss after the mysterious disappearance of over 200,000 pounds of sugar).

Specific performance is generally not available for contracts in which the goods are neither intrinsically unique nor described by the contract in terms of a particular location. Bunge Corp. v. Recker, 519 F.2d 449 (8th Cir. 1975) (seller not excused in absence of a contractual requirement to grow the crop on particular land); Dunavant Enterprises, Inc. v. Ford, 294 So. 2d 788 (Miss. 1974). One commentator gave the following illustration:

> A farmer who has contracted to sell a ton of beans would not be excused by this section [2-613] if he had no beans because of a crop failure. Beans, as thus used in the contract, are not unique, and the farmer would have to procure them from someone else in order to perform and avoid a breach of the contract. But if the farmer contracted to sell beans grown on designated land, the failure of that specific crop would excuse him.

Hawkland, *supra* note 44, at 121.

[69]Pearce-Young-Angel Co. v. Charles R. Allen, Inc., 213 S.C. 578, 50 S.E.2d 698 (1948). *See* note 62 *supra*.

[70]46 L.J.Q.B. 147 (1876).

to be grown on his land because that specific crop was destroyed.[71] If the farmer had merely promised to deliver a certain crop without reference to growth in a specific location, he would not have been excused.[72] In the latter case, the seller could go into the market, buy the goods, and perform. If, in the hypothetical case, the designation of a specific warehouse renders the widgets unique, and the warehouse is destroyed, the seller would be excused under *Howell v. Coupland.*

If it could be shown that the designation of that particular warehouse was not through any special choice of the parties but was a mere administrative convenience, that new widgets were constantly available in the market, and that since the making of the contract the price of widgets had risen considerably, it would seem unjust to allow the seller to avoid the contract. The standard of the current section 2-613 is that the contract requires for its performance goods identified to the contract. Certainly, goods so identified are not required for the performance of the contract, yet under section 2-613, it is possible that the seller may avoid performance even if the warehouse and its contents are destroyed.

To ascertain whether the goods are required to be identified to the contract one can use a simple test. Assume, after the warehouse was destroyed, that the seller had delivered 1,000 widgets to the buyer from another warehouse. To allow the buyer to reject the widgets as non-conforming under section 2-601 because they did not come from the original warehouse specified would be commercially silly. One should read section 2-613 to mean that for goods to be required for the performance of the contracts, they must be unique, that is, irreplaceable by commerically reasonable standards. This would exclude from section 2-613 identified goods which could be replaced in a commercially reasonable manner. Section 2-613 is clearly misnamed. It does not apply to casualty to all identified goods.[73]

The decision in *Valley Forge Flag Co. v. New York Dowel & Moulding Import Co.*[74] illustrates that section 2-613 does not and should not apply to every case in which goods are identified. In *Valley Forge* the plaintiff-buyer agreed to purchase 30,000 5/16 × 24″ Ramin Dowels and 100,000 3/8 × 30″ Ramin Dowels. At the time

[71]*Id.* at 148-50. American jurisdictions have also held that performance is excused under a contract for the sale of agricultural products or lumber to be grown on specific lands when conditions rendered performance impossible. *See* Ontario Deciduous Fruit-Growers Ass'n v. Cutting Fruit-Packing Co., 134 Cal. 21, 66 P. 28 (1901); Matousek v. Galligan, 104 Neb. 731, 178 N.W. 510 (1920); International Paper Co. v. Rockefeller, 161 A.D. 180, 146 N.Y.S. 371 (1914); note 68 *supra.*

[72]Colley v. Bi-State, Inc., 21 Wash. App. 769, 586 P.2d 908 (1978). A farmer who contracted to sell 25,000 bushels of wheat failed to deliver due to dry weather. The court did not excuse performance, ruling that wheat was not identified within the meaning of U.C.C. § 2-613. *Id.* at 774, 586 P.2d at 911-12.

[73]*See* [1980] 3A BENDER'S U.C.C. SERV., SALES & BULK TRANSFERS § 14.13(3).

[74]395 N.Y.S.2d 138 (Civ. Ct. N.Y. 1977).

of the contract, the goods were not identified to the contract. No specific dowels were designated and they were not a part of an identified fungible bulk. The defendant-seller shipped the dowels to the plaintiff. At this point the dowels became identified to the contract according to section 2-501(b) because the seller had selected certain dowels. Subsequently, the ship carrying the dowels was destroyed and the dowels were lost. The defendant claimed he should be excused from his contract under section 2-613. The court disagreed:

> Section 2-613 "has application in the limited situations where the continued existence of identified goods is a presupposition of the agreement. The sale of a unique chattel comes within its scope, but not the sale of chattels, any one of which fitting the description of the contract may be delivered." . . . Thus, with respect to fungible goods more than just an identification in a sales contract by kind and amount is necessary to come within the meaning of the section.[75]

Here the court is using the word "identification" in a generic sense, and not as a term of art. Mere description of the type of goods to be delivered was not sufficient. These goods were "identified" to the exclusion of all other dowels not at the making of the contract but rather at the time of shipment. Since the dowels were fungible and the contract did not require for its performance a specific bunch of dowels, section 2-613 was inapplicable.[76]

The court in *Valley Forge* further recognized that the seller's claim was basically a claim of impossibility based on the uniqueness of the item. Having decided the dowels were fungible and not required to be identified at the time of the contract, the court said that "the goods were not 'identified' within [the] meaning of § 2-613."[77] Application of section 2-613 thus requires more than mere identification. The identified goods must also be commercially irreplaceable.

V. CONCLUSION

Identification as a legal term of art in the UCC is so broad and ill-defined that it is of dubious value in those cases where identification is crucial. The term should be either replaced by more precise nomenclature or limited to the definition suggested in this Article: specification of the goods to the contract so that the contract can apply to no others.

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[75]395 N.Y.S.2d at 139 (quoting 3A BENDER'S, *supra* note 73).

[76]395 N.Y.S.2d at 139. *See also* Henry Heide, Inc. v. Atlantic Mut. Ins. Co., 80 Misc. 2d 485, 363 N.Y.S.2d 515 (1975) (buyer's right to recover not defeated by failure to segregate shares in a fungible bulk).

[77]395 N.Y.S.2d at 139.

Extraterritorial Expropriations

*Clyde H. Crockett**

I. INTRODUCTION

It is established doctrine in American law that "the courts of one country will not sit in judgment on the acts of the government of another done within its own territory."[1] This rule of deference to foreign governmental acts, now known as the Act of State Doctrine, has its roots and most significant role in the judicial treatment of foreign acts of expropriation. In 1918, the United States Supreme Court first confirmed that the rule applied to the question of the validity of foreign governmental seizures of property[2] and in 1964, in the celebrated case of *Banco Nacional de Cuba v. Sabbatino*,[3] the Court held the doctrine applicable to a taking of property by a recognized foreign government within its territory, even though the taking allegedly violated customary international law.[4]

Since the 1930's, lower federal and state courts have recognized an exception to the Act of State Doctrine which the *Restatement (Second) Foreign Relations Law of the United States* sets forth as follows: "The [Act of State Doctrine] does not prevent examination of the validity of an act of a foreign state with respect to a thing located, or an interest localized, outside of its territory if the act has

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*Professor of Law, Indiana University School of Law—Indianapolis J.D., University of Texas, 1965; L.L.M., University of London, London School of Economics and Political Science, 1972.

[1]Underhill v. Hernandez, 168 U.S. 250, 252 (1897).

[2]Ricaud v. American Metal Co., 246 U.S. 304 (1918); Oetjen v. Central Leather Co., 246 U.S. 297 (1918).

[3]376 U.S. 398 (1964).

[4]*Id.* at 421-23. After the *Sabbatino* decision, Congress enacted the Hickenlooper Amendment as part of the Foreign Assistance Act of 1961. Pub. L. No. 88-633, § 301(d), 78 Stat. 1013 (1964) (codified at 22 U.S.C. § 2370(e)(2) (1964)). The Amendment in its present form provides in pertinent part:

> Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right to property is asserted by any party including a foreign state (or a party claiming through such state) based upon (or traced through) a confiscation or other taking after January 1, 1959, by an act of that state in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection . . . .

22 U.S.C. § 2370(e)(2) (1976).

The Amendment frees American courts from the Act of State Doctrine only when a taking allegedly violates international law. Thus, the treatment of other takings would still be governed by the *Sabbatino* case.

not been fully executed in accordance with applicable law."[5] This exception to the Act of State Doctrine—known as the extraterritorial exception or territorial limitation—shapes the treatment which American courts accord foreign confiscatory decrees covering property located in the United States at the effective date of the decree and owned by nationals of the expropriating government. Courts routinely find that the Act of State Doctrine is inapplicable in such cases. Hence, they examine—and frequently refuse to recognize—the decrees on the basis of American public policy.[6]

This Article will investigate the extraterritorial exception as it relates to expropriations in light of the cases invoking it and the *Sabbatino* decision. The first part of the Article will analyze the authority and rationale behind the exception. The second part will inquire into the standard which American courts use to determine whether to give effect to an extraterritorial expropriation decree, that is, American public policy.

The first question which arises is, given the basic rule of complete deference to foreign governmental acts and its underlying rationale, is it permissible and logical to treat extraterritorial expropriations differently from territorial takings? When it is urged that an act of expropriation by a foreign government should be applied as the rule of decision in a case in which the res is located outside the territorial limits of the acting state, ordinary conflict of laws principles clearly do not work well. The case is an extraordinary one, involving the public interest as well as other elements not present in an ordinary choice of private law case, such as the public law of the foreign state, the foreign policy of the United States, and the fact that one party to the underlying transaction, although not necessarily a party to the actual case, is a nation-state. The Act of State Doctrine, no matter how it is viewed legalistically, that is, as a rule of international comity or a rule of international law, is an attempt to accommodate these unique factors. At first blush, it would appear that the same extraordinariness is present when the res is located either within or without the territorial limits of the acting state. In other words, it is difficult to accept the notion that a special problem calling for the application of special rules becomes an ordinary problem subject to ordinary rules with a shift in the locus of the subject property.

Little thought had been given to this problem before *Sabbatino*. Two commentators have questioned the general validity of a

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[5]RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES § 43 (1965) [hereinafter cited as RESTATEMENT OF FOREIGN RELATIONS].

[6]*See, e.g.*, Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

territorial limitation after *Sabbatino*.[7] Although the answer is not entirely clear, this Article will conclude that *Sabbatino* does not preclude but instead supports, in some respects, a general territorial limitation in the case of foreign expropriations.

Having concluded that there has been and will continue to be a territorial limitation on the Act of State Doctrine, this Article will investigate the approach used by United States courts in determining the effect of an extraterritorial expropriation decree. The approach—judging the validity of the decree on the basis of American public policy—has substantial deficiencies. This Article will propose a different method, which is perceived as eliminating those deficiencies.

II. Bases of Jurisdiction

One aspect of the problem may be disposed of immediately by noting that there is indeed a form of territorial limitation on all acts of foreign states. As a general proposition, a state which has validly prescribed a rule of law, such as an expropriation, may enforce that rule only within its own territory.[8] Thus, if a foreign state seizes property with the intention to become the owner of it, to pass muster under international law the seizure must be accomplished within the territory of the acting state or, at any rate, outside the territory of other states. There is no doctrine or rule of law which requires United States courts to pay deference to an act of a foreign state which is unsupported by a recognized basis of jurisdiction to enforce.

The cases under consideration do not involve any violation of the principles of jurisdiction to enforce a rule of law. In the typical extraterritorial expropriation case, the foreign state simply has decreed ownership of property which has a situs in the United

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[7]Henkin, *The Foreign Affairs Power of the Federal Courts*: Sabbatino, 64 Colum. L. Rev. 805 (1964); Comment, *Act of State Doctrine Held Inapplicable to Foreign Seizures When the Property at the Time of the Expropriation is Located Within the United States*—United Bank Ltd. v. Cosmic Int'l, Inc., 9 N.Y.U.J. Int'l L. & Pol. 515 (1976).

[8]Restatement of Foreign Relations, *supra* note 5, § 44 states in part:

> (1) A state may not exercise in the territory of another state the jurisdiction to enforce rules of law that it has under the rule stated in § 32, except to the extent that
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> . . . .
>
> (c) the other state otherwise permits its exercise of such jurisdiction.
>
> (2) A state that exercises its enforcement jurisdiction when, under the rules stated in Subsection (1), it may not do so, violates the other state's rights under international law.

States. The acting state has jurisdiction to prescribe this rule of law[9] and no illegal enforcement acts have been undertaken.

III. Origin of the Territorial Limitation

Several Supreme Court and New York Court of Appeals decisions serve as the basis for the requirement that in order for the Act of State Doctrine to be triggered with respect to an act of expropriation, the res must have been taken while within the territory of the acting state. The point of departure for examining this requirement is *Underhill v. Hernandez*,[10] in which Underhill, an American citizen, made a claim for damages for illegal detention and assault and battery against Hernandez, a leader of revolutionary forces in Venezuela, which was then in a state of civil war. In an attempt to coerce Underhill to aid the revolutionary effort, Hernandez refused to permit Underhill to leave Bolivar, Venezuela. Hernandez was acting in his capacity as military commander of the faction which subsequently gained power and was recognized by the United States as the legitimate government. The Supreme Court affirmed[11] the lower court judgment for Hernandez, stating: "Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory."[12]

In later cases involving expropriations of property, courts have interpreted the words "done within its own territory" to require that the property be *within* the territory of the acting state at the time of the expropriation for deference to be extended to the act of expropriation.[13] The assumed limitation of *Underhill* is derived from *Hatch v. Baez*,[14] an 1876 New York Supreme Court decision, in which the court dismissed the complaint of an American citizen against the former President of the Dominican Republic for "wrongs and injuries" inflicted upon the plaintiff while he was in the Dominican Republic. The court stated:

> We think that, by the universal comity of nations and the established rules of international law, the courts of one country

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[9]The prescriptive jurisdiction of the acting state is founded on the nationality basis. *Id.* § 30 provides in relevant part: "(1) A state has jurisdiction to prescribe a rule of law . . . (b) as to the status of a national or as to an interest of a national, wherever the thing or other subject-matter to which the interest relates is located."

[10]168 U.S. 250 (1897).

[11]*Id.* at 254.

[12]*Id.* at 252.

[13]*See, e.g.*, Carl Zeiss Stiftung v. V.E.B. Carl Zeiss, Jena, 293 F. Supp. 892, 910 (S.D.N.Y. 1968), *modified with respect to damages*, 433 F.2d 686 (2d Cir. 1970).

[14]14 N.Y. Sup. Ct. 596 (1876).

> are bound to abstain from sitting in judgment on the acts of another government done within its own territory. Each State is sovereign throughout its domain. The acts of the defendant for which he is sued were done by him in the exercise of that part of the sovereignty of St. Domingo which belongs to the executive department of that government. To make him amenable to a foreign jurisdiction for such acts, would be a direct assault upon the sovereignty and independence of his country.[15]

In 1918, in *Oetjen v. Central Leather Co.*[16] and *Ricaud v. American Metal Co.*,[17] the United States Supreme Court held the doctrine of *Underhill* applicable to a physical seizure of property within the territory of the acting state regardless of both the nationality of the owner and the allegation that the act violated international law.[18] The Court in *Oetjen* affirmed the view expressed by the lower court in *Underhill*, which had relied on *Hatch*, that the rule of complete deference had its basis in international comity.[19] To sit in judgment of such an act of a foreign state and possibly condemn it would "'imperil the amicable relations between governments and vex the peace of nations.'"[20]

Attempting to determine the applicability of the rule on the basis of its literal formulation is of little utility. Clearly, the acts involved in *Ricaud* and *Oetjen* were carried out within the territory of the acting state. What, however, of the situation in which the only act performed by the state is the issuance of a decree of expropriation? Arguably, if the decree is issued in the territory of the acting state, the act of expropriation is "done within its own territory," regardless of the situs of the property, and the decreeing state is owner of the property. On the other hand, it may be argued on the basis of *Sabbatino*[21] and the *Restatement of Foreign Relations*[22] that when the subject property is located outside the territory of the acting state, no "taking" has occurred because the act has not been "executed in accordance with applicable law,"[23] that is, not "done within its own territory."[24] In some cases, a finding that the acting

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[15]*Id.* at 599.

[16]246 U.S. 297 (1918).

[17]246 U.S. 304 (1918).

[18]Oetjen v. Central Leather Co., 246 U.S. at 303; Ricaud v. American Metal Co., 246 U.S. at 309.

[19]246 U.S. at 303-04.

[20]*Id.* at 304.

[21]*Sabbatino* is discussed at notes 47-66 *infra* and accompanying text.

[22]RESTATEMENT OF FOREIGN RELATIONS, *supra* note 5, § 43.

[23]*Id.*

[24]Only "takings" of property are entitled to deference under the Act of State Doctrine. In *Sabbatino*, the Court concluded that the Cuban expropriation law had

state did not intend its expropriatory decree to encompass property located outside its territory is appropriate. In the typical case under consideration, however, the intention of the acting state to confiscate property located outside of its territory is clearly evidenced in the decree or other pronouncements. Although the inability and failure of the state to take certain enforcement steps may well be a basis for differentiating extraterritorial acts from intraterritorial ones, it would seem that the applicability of the Act of State Doctrine should not turn upon the interpretation of ambiguous expressions in a vacuum.

When, as in *Oetjen* and *Ricaud*, property is located within the territory of the state which expropriates it, no other state can legally perform the act of expropriation without the consent of the territorial state.[25] Although it is generally a valid exercise of prescriptive jurisdiction for, say, the United States to decree expropriation of American-owned property located in Mexico,[26] United States agencies may not, as a general proposition, legally seize the property *in Mexico*. In the latter sense, the jurisdiction of the territorial state to enforce the decree is exclusive.

The formulative cases suggest that to condemn a state's valid exercise of exclusive jurisdiction to enforce a rule of law in effect denies the state's independence. Therefore, such a denial "'imperil[s] the amicable relations between governments and vex[es] the peace of nations.'"[27]

When the subject of the expropriation is located extraterritorially, that is, in the territory of some other state, the jurisdiction of the acting state ceases to be exclusive. In such a case, the state in which the property is located has jurisdiction to prescribe the rule, based on the territorial principle.[28] Sitting in judgment of such an act arguably would not jeopardize the needs of international comity, for

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been "fully executed within the foreign state" and that there had been "an effective taking" of the subject property. 376 U.S. at 414. Whether the act has been executed and whether there has been a "taking" depend upon the "applicable law." *See* RESTATEMENT OF FOREIGN RELATIONS, *supra* note 5, § 43. Certainly, concluding that the law which governs such questions is the law of the acting state is as reasonable as holding American law applicable.

[25]*See* note 8 *supra* and accompanying text.

[26]In such a case, jurisdiction to prescribe is based on nationality. *See* note 9 *supra*

[27]Oetjen v. Central Leather Co., 246 U.S. at 304.

[28]RESTATEMENT OF FOREIGN RELATIONS, *supra* note 5, § 17 provides:

A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory and

(b) relating to a thing located, or a status or other interest localized in its territory.

there would be no denial of or interference with an exclusive jurisdiction.

Due to the paucity of early cases, none of which even remotely involved extraterritorial expropriations, one can only speculate how the Supreme Court during the formative era would have approached an act of extraterritorial expropriation in light of the Act of State Doctrine. The Court might have concluded, without more, that the doctrine was a rule of international law[29] which the nation-states, in cases of expropriation, were bound to apply only when the res was located within the territory of the acting state. The Court might even have concluded that if the object of a foreign expropriatory decree were located in the United States, the decree would not be entitled to any consideration because the acting state lacked a base of prescriptive jurisdiction.[30]

IV. Development of the Territorial Limitation in the American Courts

The extraterritorial exception had its genesis in the United States in a series of New York state court cases involving the early nationalization programs of the government of Soviet Russia. For the first time in the judicial history of the United States, the courts were confronted with expropriation decrees which purported to apply to property belonging to nationals of the Soviet Union wherever such property was located.

Before the United States recognized the Soviet Union, the New York courts viewed Soviet edicts and decrees confiscating property of Soviet nationals located in New York as legal nullities;[31] however, the decrees were on occasion given effect in the interest of justice.[32] After the United States had recognized the Soviet government, the decrees of the Soviet Union became law. Nevertheless, until the Supreme Court's 1937 decision in *United States v. Belmont*,[33] the New York courts continued to deny effect to Soviet extraterritorial expropriation decrees on the basis that they were contrary to New

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[29]The New York court adopted this view in Hatch v. Baez, 14 N.Y. Sup. Ct. 596, 599 (1876), which served as the basis for the rule announced by the Supreme Court in *Underhill*.

[30]Although it is clear today that prescriptive jurisdiction based upon nationality is permissible, several cases decided during the earliest part of this century indicated that laws meant to affect property located outside the territory of the state of enactment were legal nullities. *See, e.g.*, Baglin v. Cusenier Co., 221 U.S. 580 (1911).

[31]*See, e.g.*, Petrogradsky Mejdunarodny Kommerchesky Bank v. National City Bank, 253 N.Y. 23, 170 N.E. 479 (1930); Sokoloff v. National City Bank, 239 N.Y. 158, 145 N.E. 917 (1924).

[32]*See, e.g.*, Salimoff & Co. v. Standard Oil Co., 262 N.Y. 220, 186 N.E. 679 (1933).

[33]301 U.S. 324 (1937).

York's public policy.[34] Although the courts failed to offer explicit reasoning, they must have viewed the Act of State Doctrine as inapplicable. There is some suggestion that New York's strong public policy would have defeated the argument that considerations of comity should lead to effectuation of the decrees.[35] Even intra-territorial acts, that is, acts confiscating property of Soviet nationals located in the Soviet Union, which seemingly fell within the scope of the *Underhill* doctrine, were evaluated under the public policy of New York. The outcome, however, was the same as if the Act of State Doctrine had been applied: when the subject property was located in the territory of the Soviet Union, public policy dictated giving effect to the decrees.[36]

The New York approach underwent a significant change in 1937, when the Supreme Court decided *United States v. Belmont*.[37] *Belmont* involved a Soviet expropriatory decree covering the property of a Russian corporation, including money on deposit with a New York banker, Belmont. In 1933, the Soviet government had assigned its claim to the money to the United States. The United States sued to recover the assigned bank deposit. The lower court held that a judgment for the United States would for practical purposes give effect to an act of confiscation of property located in New York. Thus, the lower court refused to enforce the decree based on the public policy of New York.[38] The Supreme Court reversed, holding that the President's recognition of the Soviet government, the establishment of diplomatic relations between the two governments, and the assignment, resulted in an international compact between the United States and the Soviet Union which took precedence over New York's public policy.[39]

The opinion included a lengthy recitation of the *Underhill* principle and a discussion of the applicability of that principle to foreign confiscations.[40] Why the Court found it necessary to cite *Underhill*, *Oetjen*, and *Ricaud* is unclear. The majority opinion seems to suggest that the Act of State Doctrine encompasses extraterritorial confiscations. Justice Stone apparently recognized this and, in a concurring opinion, pointed out that the cited cases did not preclude New York from invoking its public policy in relation to confiscatory decrees covering property located in New York and not subject to

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[34]*See, e.g.*, Vladikavazsky Ry. v. New York Trust Co., 263 N.Y. 369, 189 N.E. 456 (1934).

[35]*Id.* at 378, 189 N.E. at 460.

[36]*See, e.g.*, Dougherty v. Equitable Life Assurance Soc'y, 266 N.Y. 71, 193 N.E. 897 (1934).

[37]301 U.S. 324 (1937).

[38]*Id.* at 327.

[39]*Id.* at 330.

[40]*Id.* at 327-28.

the international compact entered into by the two governments. In other words, the case turned upon the principle that a treaty took precedence over state law and policy.[41]

In 1939, in *Moscow Fire Insurance Co. v. Bank of New York & Trust Co.*,[42] the New York Court of Appeals dealt with an issue similar to that presented in *Belmont*. In a series of decrees beginning in 1918, the Soviet Union had purported to confiscate the property of Russian insurance companies. Moscow Fire Insurance Company was a Russian corporation which had done business in New York since 1899. In 1933, the United States recognized the government of the Soviet Union, which assigned whatever claim it had to the assets of the company to the United States. By virtue of earlier litigation, the Moscow Fire Insurance Company had been liquidated and the surplus assets deposited with the respondent bank.

The issue in *Moscow* was the proper distribution of these surplus assets, which were claimed by the United States on the basis of the assignment. The court first distinguished the situation from that presented in *Belmont*:

> The United States has not invoked the judicial authority of the States in aid of an agreement it has consummated, calculated to give the decrees of the Soviet government force beyond the force given to decrees of other recognized governments. It invokes the aid of the court only to enforce rights of the Soviet government, whatever they might be, which the United States has acquired by assignment . . . .[43]

The court then refused to recognize the decrees, not because recognition would contravene New York's public policy, but because under New York *law*, as applicable under traditional conflict of laws principles, the assets belonged to the directors of the Moscow Fire Insurance Company.[44] New York law was deemed applicable because the property was located in New York and, under traditional conflicts principles, the ownership of property is governed by the law of the situs. The court indicated that the Act of State Doctrine was applicable only when no choice of law issue was presented.[45]

It is submitted, first, that the *Moscow* court's approach was adopted to avoid conflict with that portion of the *Belmont* decision prohibiting the use of state public policy to determine the effect to be given to an expropriatory decree. It is further proposed that the

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[41]*Id.* at 333-37 (Stone, J., concurring).
[42]280 N.Y. 286, 20 N.E.2d 758 (1939), *aff'd*, 309 U.S. 624 (1940).
[43]*Id.* at 304, 20 N.E.2d at 764.
[44]*Id.* at 314, 20 N.E.2d at 769.
[45]*Id.* at 311, 20 N.E.2d at 768.

Moscow rationale for excepting extraterritorial expropriatory decrees from the orbit of the Act of State Doctrine is of doubtful validity. It may well be that the Act of State Doctrine is triggered only when property which is the subject of an expropriatory decree has been located at some point within the territory of the decreeing state. It is quite another thing to suggest that the law of the decreeing state is applied only when *ordinary* rules of conflict of laws direct its application. In the first place, the traditional choice of law rule was developed in the arena of private transactions which involve minimal public interests, at best.

Second, the traditional rule was developed to facilitate a choice between rules which themselves are designed to govern private transactions, not to determine whether an act of state should be given effect.

Third, the notion that an act of state is not applicable because of the choice of law rule is somewhat absurd when the act is by its very terms applicable. Ordinary choice of law rules work well when a court has before it two or more conflicting rules of law cast in general language which express nothing about their territorial scope. In contrast, an act of expropriation usually applies to specific property in specific places.

Fourth, one cannot assume that there is any applicable law other than the law of the acting state, that is, the decree itself, in a case of extraterritorial expropriation. For example, New York's rules of law dealing with ownership of property cover strictly private transactions and transactions between the state and a private person; the rules are patently inapplicable to the situation at hand.

Fifth, one may argue that New York does have an applicable rule, that is, a judicially fashioned rule. This argument assumes, however, that the New York court has the power to devise and apply such a rule. Certainly the choice of law rule does not give it such a power. The existence of the power depends in part upon whether there is an extraterritorial limitation on the Act of State Doctrine, which obviously begs the question.[46]

In *United States v. Pink*,[47] involving an issue hardly distinguishable from that in *Moscow*, the Court determined that the public policy of the United States favoring judicial recognition of Soviet extraterritorial decrees took precedence over state policy and law.[48]

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[46]It should also be noted that neither the Act of State Doctrine nor ordinary conflicts rules are meant to deal with conflicting exercises of jurisdiction when such exercises are intended to further the public interest. In the typical case, there has been but one exercise of jurisdiction. *Moscow* may be viewed as an atypical case, that is, one involving conflicting exercises of jurisdiction in the public interest.

[47]315 U.S. 203 (1942).

[48]*Id.* at 231-34.

Pink provides additional support for the proposition that the *Underhill* principle is not intended to apply to extraterritorial decrees. Although the Court cited *Oetjen* and *Ricaud*, it did not rely on them.

In summary, two aspects of the formative cases, federal and state, are worthy of mention. Although no Supreme Court decision has explicitly determined the applicability of the Act of State Doctrine vis-a-vis extraterritorial expropriations, the rationale of the doctrine has seemingly presented no bar to judicial evaluation of such acts.

The New York cases are scarcely helpful in this regard. Pre-*Moscow* cases suggest that the New York courts did not view the Act of State Doctrine as precluding the utilization of New York public policy in any case. In that era, the courts had not yet concluded that the scope of the Act of State Doctrine was to be determined by federal law rather than state law. Although the Court in *United States v. Pink* made clear that in regard to the question of the effect of foreign expropriatory decrees, federal policy favoring recognition would take precedence over conflicting state policy,[49] the Court neither confirmed the validity of nor offered a rationale for a general territorial limitation. Nevertheless, the territorial limitation acquired a life of its own and was not questioned until after the Supreme Court's ruling in *Banco Nacional de Cuba v. Sabbatino*.[50]

V. THE IMPACT OF *Banco Nacional de Cuba v. Sabbatino* ON THE EXTRATERRITORIAL EXCEPTION

In 1960, in response to an American reduction of the Cuban sugar quota, Cuba expropriated property belonging to American nationals. The decree became effective when sugar belonging to C.A.V., a Cuban corporation owned principally by American nationals, was aboard a vessel in Cuban territorial waters. In furtherance of its decree, Cuba detained the vessel until the purchaser's agent, Farr, Whitlock and Company, had agreed that the proceeds from the contemplated sale of the sugar would be paid to the Banco Exterior, an agency of the Cuban government, rather than to C.A.V. The agreement between Farr, Whitlock and the Cuban bank recognized Cuban ownership of the sugar. Farr, Whitlock refused to turn over the proceeds of the sale of the sugar to the Banco Nacional, another instrumentality of the Cuban government to which the Banco Exterior had assigned the bill of lading. Banco Nacional sued Sabbatino, the receiver of C.A.V.'s New York assets, for recovery of the proceeds. Sabbatino successfully contended

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[49] *Id.* at 230-31.

[50] 376 U.S. 398 (1964).

in both the District Court[51] and Circuit Court of Appeals[52] that the Cuban decree should not be recognized because it violated international law.

The Supreme Court reversed, holding that the Act of State Doctrine precluded judicial examination of "the validity of a taking of property within its own territory by a foreign sovereign government . . . even if the complaint alleges that the taking violates customary international law."[53]

Although the cases bear a strong resemblance, the Court in *Sabbatino* did not rely solely on *Ricaud*. In *Sabbatino* the Court redefined the rationale underlying the rule of complete deference to acts of foreign states. It did not believe that the Act of State Doctrine was commanded "by the inherent nature of sovereign authority,"[54] as earlier cases had suggested, or by international law.[55] Neither was the rule compelled by the Constitution of the United States.[56] However, the Court stated that

> [t]he act of state doctrine does . . . have "constitutional" underpinnings. It arises out of the basic relationships between branches of government in a system of separation of powers. It concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations. The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere.[57]

Thus, the Court found the real rationale for the rule of complete deference in the separation of powers concept. Because most questions concerning the conduct of foreign relations are political rather than legal, they are proper subjects for executive action rather than judicial decision. Nevertheless, the Court noted that the judiciary would decide certain cases touching on foreign relations.[58] The Court

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[51]193 F. Supp. 375 (S.D.N.Y. 1961).

[52]307 F.2d 845 (2d Cir. 1962).

[53]376 U.S. at 428. In response to *Sabbatino*, Congress enacted the Hickenlooper Amendment, 22 U.S.C. § 2370(e)(2) (1976), which provides in essence that the Act of State Doctrine will not bar a judicial determination on the merits when a taking allegedly violates international law. *See* note 4 *supra*.

[54]376 U.S. at 421 (citing Oetjen v. Central Leather Co., 246 U.S. 297 (1917); American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909); Underhill v. Hernandez, 168 U.S. 250 (1897)).

[55]376 U.S. at 421.

[56]*Id.* at 423.

[57]*Id.*

[58]*Id.*

advised consideration of the following factors to determine whether a particular question is appropriate for judicial decision:

(1) The degree of codification or consensus attending the particular area of international law.[59] In *Sabbatino*, the Court noted a lack of codification or consensus in international law concerning the need for compensation for a taking of property.[60]

(2) The impact of judicial decision on American foreign relations. The Court found that the question whether a state may validly expropriate the property of an alien without compensation to be sensitive in view of its direct relationship to the national interests of capital importing nations and those which do not "adhere to a free enterprise system."[61] Because of the sensitivity of the issue, a pronouncement by a United States court that the taking was invalid would likely insult the foreign state and interfere with negotiations pending between the foreign state and the Executive Branch.[62] Furthermore, judicial decisions would be at best piecemeal and thus could not contribute meaningfully to the development of international law.[63] And although a finding of validity would not offend the foreign state, it would likely embarrass the State Department and be detrimental to American interests.[64]

(3) Existence of the acting government. If the acting government is no longer in existence, a judicial decision will not conflict with or embarrass the Executive Branch or insult the foreign government.[65]

The Court also indicated that allowing a court to judge an act of a foreign state might "render uncertain titles in foreign commerce, with the possible consequence of altering the flow of international trade."[66]

According to several commentators,[67] the *Sabbatino* Court's redefinition of the rationale for complete deference to acts of state has cast doubt on the validity of a general extraterritorial exception: to justify sitting in judgment, courts must now consider the needs of international comity in light of the separation of powers theory rather than the inherent nature of sovereign authority. In other words, the pre-*Sabbatino* rationale for the territorial limitation was that because the acting state did not have exclusive jurisdiction

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[59]*Id.* at 428.
[60]*Id.* at 428-30.
[61]*Id.* at 430.
[62]*Id.* at 432.
[63]*Id.* at 434.
[64]*Id.* at 432.
[65]*Id.* at 428.
[66]*Id.* at 433.
[67]*See, e.g.*, Henkin, *supra* note 7, at 826; Comment, *supra* note 7, at 532-34.

when the object of a foreign expropriatory decree was located in the United States, an American court would not offend international comity by judging the foreign act of state. After *Sabbatino*, however, courts must ask whether sitting in judgment of acts of extraterritorial expropriation "may hinder . . . this country's pursuit of goals both for itself and for the community of nations as a whole . . . ."[68]

The Court in *Sabbatino* did not expressly resolve the issue of the applicability of the Act of State Doctrine to extraterritorial expropriations. Nevertheless, *Sabbatino* may be viewed generally as restricting rather than expanding the ambit of the doctrine. This observation follows from the very refusal of the Court to rest the doctrine on the inherent nature of sovereign authority. In other words, it appears that the Court intended to indicate that there may be cases in which acts clearly done within the territory of the acting state will not escape judicial scrutiny; before *Sabbatino*, this factor alone arguably precluded sitting in judgment by a United States court. The question remains whether the *Sabbatino* Court intended to reject similar restrictions on the doctrine's scope with respect to extraterritorial expropriations.

Sabbatino has prompted several lower federal courts to rationalize the territorial limitation. In *Maltina Corp. v. Cawy Bottling Co.*,[69] the Court of Appeals for the Fifth Circuit provided a lengthy defense of the extraterritorial exception. The court noted that in past cases in which the Act of State Doctrine had been applied to acts of expropriation, the act had "come to complete fruition" in the territory of the acting state.[70] The expropriation was a "fait accompli," so that as a practical matter, it could not have been prevented.[71] On the other hand, the court indicated that when the res is located in the United States at the time of issuance of the decree, the act cannot "come to complete fruition" without the cooperation of the courts of the United States.[72] Furthermore, "there is something the forum state can do to prevent the expropriation, because the property is plainly within the physical control of the forum state."[73] The court then noted that

> [t]his emphasis on the completion of the Act of State squares with the policy considerations articulated in the *Sabbatino* decision. . . . The obvious inability of a foreign state to com-

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[68]376 U.S. at 423.

[69]462 F.2d 1021 (5th Cir. 1972).

[70]*Id.* at 1028. This view was taken earlier in Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706 (5th Cir.), *cert. denied*, 393 U.S. 924 (1968).

[71]462 F.2d at 1028.

[72]*Id.*

[73]*Id.* (citing Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706 (5th Cir.), *cert. denied*, 393 U.S. 924 (1968)).

> plete an expropriation of property beyond its borders reduces the foreign state's expectations of dominion over that property . . . . Consequently, the potential for offense to the foreign state is reduced, there is less danger that judicial disposition of the property will "vex the peace of nations," and there is less need for judicial deference to the foreign affairs competence of the other branches of government.[74]

Particular aspects of the court's argument are unconvincing. First, a foreign expropriation being challenged in a United States court is never a "fait accompli" until the court so declares it, regardless of what the acting state did or where the property happened to be located at any particular time. Although *Ricaud*, *Oetjen*, and *Sabbatino* involved the exercise of various acts of dominion or control over the property by the foreign sovereign, the property nevertheless came under the jurisdiction of the United States courts. In each case, the United States court could have prevented the expropriation by refusing to recognize the decree's intended effect. Furthermore, the court could have enforced its decision that the foreign state had not acquired ownership of the property.

Thus, the *Maltina* court's conclusion that there is a lower potential for insult to the acting state in the extraterritorial expropriation context is unsound to the extent that it rests on the "fait accompli" theory. However, the court's conclusion is plausible when disengaged from the "fait accompli" rationale. In the extraterritorial expropriations setting, the foreign state has prescriptive jurisdiction under the principle of nationality rather than territoriality. It could be argued that when the acting state lacks territorial jurisdiction, its expectations of being recognized as the owner and, consequently, the potential for offense from a judicial refusal to recognize ownership, are reduced substantially.

If one accepts the proposition that in the typical extraterritorial expropriation case, sitting in judgment of the act involved will carry with it less danger of offending the acting state because of that state's limited expectations, the further question remains whether this conclusion alone suffices to support a general territorial limitation upon the Act of State Doctrine. First, it should be noted that, unlike the situation presented in *Sabbatino*, there is no violation of international law when a state expropriates the property of one of its nationals, assuming that no illegal acts of enforcement have occurred. Next, one may question whether the territorial limitation

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[74]462 F.2d at 1028-29.

is justified under the other factors which the Court in *Sabbatino* used to determine the propriety of judging a foreign act of state.

The Court in *Sabbatino* considered the possibility of interfering with negotiations ensuing or likely to ensue between the United States and the acting state to be a strong reason for refusing to examine the validity of a taking of property within its own territory by a foreign sovereign. In the typical extraterritorial case, however, there will be no negotiations pending between the United States and the acting state with respect to the particular expropriation because the State Department is not likely to take up the claim of a foreign national.

It has been suggested that *Sabbatino* demands judicial consideration of additional factors in determining whether to examine a foreign act of state.[75] To be sure, the Court in *Sabbatino* devoted a good deal of attention to the degree of codification or consensus attending the standard alleged to be appropriate in evaluating the act of state, to wit, the international law of expropriation. The impact of this factor is attenuated in the extraterritorial context because the standard employed by the courts in judging the foreign decree is American public policy rather than international law.[76] Any lack of codification and consensus surrounding American public policy obviously would not engender disagreements between nation-states. The use of American public policy to deny effect does not necessitate a decision that international law—a law to which the acting state is subject and which is formulated by the practices of states, including the acting state—has been violated. To be sure, both the lower courts and the Supreme Court in *Sabbatino* by implication rejected public policy as the standard for judging foreign governmental acts. In evaluating the rejection, however, one must consider the fact that the expropriation was territorial and of alien-owned property. Although the application of American public policy in this context has not been viewed as controversial, this writer considers it inappropriate for reasons which will be discussed later.

In *Sabbatino* the Court also mentioned the availability of another forum as a reason for judicial refusal to examine a foreign act of state. However important that factor may have been in *Sabbatino*, which involved injured Americans who could seek redress through

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[75]The author of a provocative Comment concerning United Bank Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868 (2d Cir. 1976), takes the view that *Sabbatino* requires the judiciary to approach extraterritorial expropriations on a "case-by-case balancing-of-relevant-considerations approach." Comment, *supra* note 7, at 535. This approach would demand excessive precision of lower federal courts; both the rule and reasoning of *Sabbatino* were quite general.

[76]*See, e.g.*, Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

the State Department, the typical extraterritorial expropriation case involves, at best, a highly remote possibility that any forum apart from the United States court exists for resolving the issue.

In summary, *Sabbatino* constitutes only a small and easily surmountable obstacle toward recognizing a general territorial limitation on the Act of State Doctrine as it applies to expropriating acts. Even if one agrees with the view advanced by one commentator that *Sabbatino* requires the courts to approach each extraterritorial expropriation on an ad hoc basis,[77] it is highly likely that only a few extreme cases would qualify for application of the Act of State Doctrine. Thus, in the great majority of cases, the courts would be able to proceed just as they always have, that is, by denying enforcement on the basis of American public policy.

VI. Standard for Judging Acts of Extraterritorial Expropriation

The question of the proper standard by which to judge an extraterritorial expropriation decree represents a greater problem and one which is more susceptible to satisfactory solution than the threshold question of the applicability of the Act of State Doctrine. Although sitting in judgment and denying the effect of extraterritorial acts are permissible, the standard used by the courts to examine such acts—American public policy—is unreasonable and should be changed.

A court's conclusion that the Act of State Doctrine is inapplicable to an act of extraterritorial expropriation does not automatically reveal the basis upon which the act should be judged. More specifically, a judicial decision that the doctrine is inapplicable to a particular act does not inevitably call for denial of the act's effect. The problem lies in determining the proper basis upon which to decide whether to give effect to the act.

The present standard for deciding whether to give effect to an extraterritorial expropriation, that is, American public policy, is not the only imaginable standard. For instance, a United States court might conceivably examine the foreign act under the law of the foreign state. When a foreign government has confiscated the property of one of its nationals, it may well be that the state has violated its own law, a law to which it is obviously subject. However, American courts do not inquire into the validity of foreign governmental acts under the law of the acting state. The principal justifications for the refusal are the likelihood of insulting a state by an American court's determining that the state has violated its own

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[77] *See* note 75 *supra*.

law and the likelihood of error in discovering and interpreting foreign public law.[78] Nor do rules of international law provide a basis for denying effect in the typical case under consideration. Nevertheless, international law may play a role when, for example, the acting state has violated rules relating to prescriptive or enforcement jurisdiction. Thus, the situation is one in which the acting state, although it has violated neither international law nor its own law, must pass the test of American public policy.

A. The Public Policy Standard

Public policy was first used to evaluate extraterritorial expropriations in a series of New York cases dealing with the Soviet nationalization program.[79] The series evidences no little antipathy of the New York courts to Soviet decrees, which is not surprising in view of the magnitude and unprecedented nature of the nationalization, the nonrecognition policy assumed initially by the United States government, and the courts' general disdain for institutions so drastically opposed to ideals cherished in the United States. Public policy was a natural choice as the device for judging the Soviet decrees; time-honored, expedient, and devastating, its application involved none of the uncertainty surrounding the international comity standard.

The leading modern case defining public policy in the extraterritorial expropriation setting is *Republic of Iraq v. First National City Bank*,[80] a 1965 Second Circuit decision. In 1958, King Faisal was assassinated and his government overthrown. The successor government issued a decree which purported to confiscate all the property of the former dynasty wherever located. On the basis of the decree, the Republic of Iraq sued to recover King Faisal's account and shares in a Canadian investment trust held in a New York bank. The court applied the extraterritorial exception, refusing to give effect to the decree on the basis that to do so would be contrary to the public policy of the United States against confiscation.[81] The court found the source of the public policy in various provisions of the federal Constitution prohibiting confiscatory action by the United States or a state[82] and noted that "[f]oreigners entrusting their property to custodians in this country are entitled to expect this historic policy to be followed save when the weightiest reasons call for a departure."[83] Finally, the court observed that "the policy of

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[78]Banco Nacional de Cuba v. Sabbatino, 376 U.S. at 415 n.17.

[79]*See* cases discussed at notes 31-36 *supra* and accompanying text.

[80]353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

[81]353 F.2d at 51.

[82]*Id.* (citing U.S. CONST. amends. V, XIV; *id.* art. I, § 9, cl. 2).

[83]353 F.2d at 52.

the United States is that there is no such thing as a 'good' confiscation by legislative or executive decree."[84]

Today, confiscations by foreign governments have become commonplace. The very fact of their multiplicity raises a question about the continued vitality of utilizing public policy as the standard by which to judge extraterritorial acts.

There are, as well, more serious objections to the use of public policy. As it is presently applied, public policy requires that the court inquire whether enforcing a foreign law would be contrary to good morals, deep-seated traditions, and principles of natural justice. It is doubtful that any court applying this test would declare, as did the court in *Republic of Iraq*, that "there is no such thing as a 'good' confiscation . . . ."[85]

In *Sabbatino*, both the district court[86] and court of appeals[87] had refused to evaluate the act on the basis of American public policy, judging it only on the basis of international law. The court of appeals observed that under the generally accepted Cardozo definition of public policy, the taking of property without compensation would likely be contrary to a "fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal."[88] However, the appellate court believed that the public policy-based concept of just compensation was developed for use in American interstate cases rather than international cases:

> [W]e are aware of the admonition that public policy is an "unruly horse." The concept has proved to be a very difficult one to confine when one seeks to apply it. We are not entirely certain what the American public would consider to be the proper policy of the United States with respect to expropriations of the property of aliens by foreign sovereigns when the property has its situs within the foreign countries. Also, decision of this case based upon the public policy of this forum is undesirable because reliance upon such a basis for decision results in a nationalistic, or municipal, solution of a problem that is clearly international.[89]

The difficulties of applying public policy surface in the extraterritorial context as well. Pinpointing the public attitude is

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[84]*Id.*
[85]*Id.*
[86]193 F. Supp. 375 (S.D.N.Y. 1961).
[87]307 F.2d 845 (2d Cir. 1962).
[88]*Id.* at 859.
[89]*Id.*

troublesome; although the typical extraterritorial case implicates weaker international concerns than those involved in the *Sabbatino*-type case, the element of international interest is nonetheless present. Courts, however, have defined public policy in a way which insures nonrecognition of extraterritorial acts and which has been criticized extensively and rejected in other areas of law.[90] The courts appear to find public policy in the literal words of positive law, that is to say, in the Constitution, but they fail to reflect on the reality that that law does not bind the whole world. Thus, public policy becomes a "substitute for analysis";[91] the true reasons for the decision are masked.

Another objection to the use of public policy is that it evidences little concern on the part of the judiciary for states whose political and economic systems differ from those of the United States. In essence, the courts' failure to take into account the particular needs of developing states amounts to a refusal to acknowledge their legitimacy. Professor Henkin has observed that the

> Act of State [Doctrine] had its origins in attitudes of respect for a nation's mastery in its own land, respect which the United States sought to foster when it was itself a "new nation" wishing to be let alone. *Sabbatino* is evidence that the United States, now a most powerful nation with interests reaching everywhere, may be prepared to accord similar respect to new small nations.[92]

It is suggested that the courts, to conform to this policy of accommodation, should abandon public policy in its present form as a device by which to decide the effect to be given to extraterritorial expropriations.

Another problem with using American public policy to judge acts of extraterritorial expropriation is that of insult to the foreign state. For an American court to announce that a foreign act of state will not be given effect primarily because it violates a law to which the acting state is not subject can scarcely fail to offend the foreign state, although the potential for offense is not sufficiently strong to trigger application of the Act of State Doctrine. The approach ignores completely, it would appear, the reasons for which the state acted.

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[90]*See* Paulsen & Sovern, *"Public Policy" in the Conflict of Laws*, 56 COLUM. L. REV. 969 (1956).

[91]*Id.* at 1016.

[92]Henkin, *supra* note 7, at 830.

B. An Alternative to the Public Policy Approach: Judging Extraterritorial Acts by the Factors of Section 6 of the Restatement (Second) of Conflict of Laws

The previous discussion is not intended to suggest that a foreign confiscation of property located here should be given effect automatically. Instead, this author proposes that criticisms could be overcome and the strong judicial tradition of respect in evaluating acts of state preserved by abandoning the present approach in favor of one which would take into account the possibility of according recognition to the foreign act.

Any act of state that becomes relevant in litigation in the United States conceivably involves the interests of the acting state, the United States, affected individuals, the judiciary of the United States, and international legal order. These diverse concerns could be reconciled by using an approach which has gained wide acceptance in the law of choice of law. The question presented in the typical extraterritorial expropriation case is closely analogous to a choice of law question: Should the law of the foreign state be applied? Although it is not an ordinary choice of law question, allowance can be made for its extraordinary nature by the suggested approach, under which a court determines applicable law by investigating the following factors: (1) The needs of the international system, (2) the policies and interests of the states involved, (3) the justified expectations of the parties, (4) the basic policies underlying the particular field of law, (5) uniformity of result, and (6) ease of application.[93] These are the factors incorporated in section 6 of the *Restatement (Second) of Conflict of Laws*[94] and used by many American courts to decide the applicable law in interstate conflict of laws cases. In many areas, the *Restatement* has discarded hard and fast jurisdiction-selecting rules, which were directed to territorially based events, in favor of general

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[93]A similar approach in regard to territorial confiscations has been suggested in Kirgis, *Act of State Exceptions and Choice of Law*, 44 U. COLO. L. REV. 173 (1972).

[94]RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971) provides:

(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include

(a) the needs of the interstate and international systems,

(b) the relevant policies of the forum,

(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

(d) the protection of justified expectations,

(e) the basic policies underlying the particular field of law,

(f) certainty, predictability and uniformity of result, and

(g) ease in the determination and application of the law to be applied.

approaches which take into account the factors of section 6 to arrive at the applicable law. The scheme of section 6 was aimed at precluding the unjust results which emanated from territorially based rules and reducing the need for artificial escape devices to avoid those rules. The approach, which centers around discovery of the state having the most significant relationship to the underlying issue, has gained much favor with American courts.[95] An analysis of the relevance of the factors of section 6 in the extraterritorial confiscation setting follows.

1. The Needs of the International System.—Although the authors of this approach consider the needs of the interstate and international systems to be of prime importance in determining the applicable law, they observe that is is often difficult to determine those needs on the interstate level.[96] Nevertheless, it is quite clear that the choice of law process on the international level should attempt to maintain harmonious relations between nation-states. Cooperation in the effectuation of respective interests serves in the long run to foster this goal. For example, recognition of the public acts of foreign states, specifically foreign expropriatory decrees, would promote good foreign relations.

Even though the *Sabbatino* Court assigned international comity a minor role in determining the effect to be given acts of state, the Court nevertheless confirmed that "historic notions of sovereign authority do bear upon the wisdom of employing the act of state doctrine . . . ."[97] Furthermore, when a foreign act of expropriation is intended to affect property in the United States, the potential for offending the acting state is merely reduced, not eliminated entirely.

The possibility always exists that an act of state is in violation of international law. Although the United States, through its courts, may as a general rule give effect to acts in violation of international law with impunity, there is much to be said for a conflicts rule discouraging this approach. Judicial refusal to give effect to acts of state in violation of international law would enhance respect for law and international legal order. Confiscation of property owned by a national of the acting state, however, is not likely to violate international law.

2. The Policies and Interests of States.—A most important factor in the interstate choice of law process is that of the interests of the

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[95]*See, e.g.*, Gutierrez v. Collins, 583 S.W.2d 312 (Tex. 1979).

[96]Cheatham & Reese, *Choice of the Applicable Law*, 52 COLUM. L. REV. 959 (1952). Although the authors' approach applies specifically to choice of law in the private context, the outlined factors may be applied logically in the public context as long as the court acknowledges that the case involves a matter of public law.

[97]376 U.S. at 421.

states involved in having their respective laws applied.[98] The theory underlying this factor is that a state interest—determined by discovering the policy of the state's law and then deciding whether the policy would be advanced by applying the law—should be furthered in the choice of law process.[99]

This factor has a rather false ring when utilized in interstate conflicts cases involving the rights and obligations of private parties. When, however, the state is directly involved, either because it is a party or because its act is being urged as the rule of decision, state interests become more clearly pertinent.[100] For instance, the power of eminent domain, an indispensable foundation of sovereignty, is essential to the vitality of a state. Prima facie, the exercise of the power furthers the acting state's interest in increasing public resources.

On the other hand, the United States may have an interest in preventing the expropriation of property located within its borders or protecting the financial well-being of American nationals. No such interest was identifiable in *Republic of Iraq*. The American bank was a mere stakeholder; no judicial decree could have protected the bank's interest in maintaining its business as depository and trustee.

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[98]B. CURRIE, *Conflict, Crisis and Confusion in New York*, in SELECTED ESSAYS ON THE CONFLICT OF LAW 690 (1963).

[99]The main choice of law theory of the *Restatement (Second)* is that the law of the state having the most significant relationship to the underlying transaction should be applied to issues arising from that transaction. This theory differs in important respects from the governmental interest approach espoused principally by Currie. Under the *Restatement* theory, applicable law is generally determined by considering the factors of section 6, which include the following: "(b) the relevant policies of the forum" and "(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(b), (c) (1971). Under governmental interest analysis, it is necessary to determine whether the policy underlying a rule of law would be furthered by applying it in the particular circumstances of the case. If so, the state in whose law the rule is contained is an interested state. Although the wording of section 6 quoted above is somewhat imprecise, it is this writer's view that 6(b) and (c) incorporate, or at least allow, the policy-interest aspect of governmental interest analysis. *See* Sedler, *The Governmental Interest Approach to Choice of Law: An Analysis and a Reformulation*, 25 UCLA L. REV. 181 (1977).

For an excellent discussion of the various current choice of law theories and methods and their utilization by American courts, *see* Westbrook, *A Survey and Evaluation of Competing Choice-of-Law Methodologies: The Case for Eclecticism*, 40 MO. L. REV. 407 (1975).

[100]Nevertheless, a clear public interest may be diminished by particular circumstances, such as declaration of the actor; nonparticipation in the proceedings; motives; or events which occur after the taking, for example, a conveyance to private persons.

The United States may have another, albeit indirect, interest in being known as a state into which an alien may bring his property without fear of its injury or loss. Aliens and their property in this country are protected by most of the constitutional safeguards afforded to American citizens.[101] This form of equality tends to insure the aforementioned interest. However, it must be stressed that the United States Constitution is inapplicable to acts of a foreign government.

A United States interest of more than a purely paternalistic nature may surface in the extraterritorial expropriation cases. For example, the United States' interest in exercising its powers of eminent domain and taxation may be injured by giving effect to a foreign decree. The attitude and position of the Executive Department are particularly relevant in identifying such an interest. In *Republic of Iraq*, the United States officially denied any concern in the outcome of the litigation. Although the United States had a direct interest in the exercise of its powers of eminent domain and taxation, neither power would have been jeopardized by giving effect to the Iraqian decree.

These cases, it must be emphasized, do not involve any attempt by the United States to exercise its own jurisdiction. Furthermore, even if it could be said that the United States has an interest in having a large amount of property within its borders so as to increase potential revenues, it is difficult to see how a decision like *Republic of Iraq* insures that the property will remain here. Other United States interests, direct and paternalistic, can be imagined, such as a concern for avoiding the adverse economic effects of a wide-scale confiscation of interest-producing assets.

3. Protection of the Justified Expectations of the Parties.—In *Maltina* the court determined *a priori* that when property is located in the United States at the time of issuance of a confiscatory decree, the acting state has a reduced expectation that its decree will be effectuated.[102] Although the absence of expectation alone would not justify denying effect, it may be used to buttress other factors pointing to denial.

With respect to the expectations of individuals, the court in *Republic of Iraq* noted that the heirs of King Faisal had the right to expect observance of the constitutionally based United States policy against confiscation of assets.[103] Determining any basis for such an expectation is difficult; because the heirs were Iraqi nationals, they

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[101]*See* Republic of Iraq v. First Nat'l City Bank, 353 F.2d at 52.

[102]462 F.2d at 1025. *Maltina* is discussed at notes 69-74 *supra* and accompanying text.

[103]353 F.2d at 51-52.

had at least as much reason to expect application of Iraqi law. Furthermore, it is doubtful that the United States, by permitting aliens to deposit money here, thereby *invites* aliens to make the United States a depository or indicates that deposited assets will be safe from confiscation by the alien's national state.

4. The Basic Policy Underlying the Particular Field of Law.—The general policy of the United States has been to give effect to foreign acts of state. Indeed, *Sabbatino* constitutes some authority for the proposition that a foreign public act is presumed valid and entitled to enforcement.[104] The court's dictum in *Republic of Iraq* that "there is no such thing as a 'good' confiscation"[105] is not only inflammatory and opposed to the basic policy of recognition, but is also inaccurate if one considers valid the many American decisions upholding rather extreme forms of governmental interference with American- and alien-owned property.

5. Uniformity, Predictability, and Certainty of Results.—The approach in its present form fosters only interstate uniformity; federal standards govern the situation in which an act of extraterritorial expropriation is attacked. The approach that "there is no such thing as a 'good' confiscation"[106] also promotes certainty and predictability of result. Although uniformity, predictability, and certainty are worthy goals in every branch of law, they tend to prompt courts to accept hard-and-fast rules without considering the need for justice in particular cases.

6. Ease of Application.—In the choice of law process, a court may have to choose between one rule which is difficult to apply and another which is familiar and therefore simple to apply. This factor of the *Restatement* would favor application of the latter rule. In the present context, giving effect and denying effect to foreign decrees would seem to be equally simple routes to decision.

The choice of law approach which a court adopts should not be greatly burdensome to the judicial process. The public policy approach is certainly simpler than that of the *Restatement*. Nevertheless, in view of the highly complex methods employed by American courts in other areas of the law, the *Restatement* approach cannot be viewed as excessively burdensome. Furthermore, these cases, although important, do not arise frequently.

An advantage of the suggested approach is that it provides an accepted framework for a respectable decision. This hierarchy was devised precisely to alleviate the general problem which had surfaced in the cases under consideration, that is, the use of hard-and-fast *ter-*

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[104]376 U.S. at 437.

[105]353 F.2d at 52.

[106]*Id.*

ritorially oriented rules which resulted in unfair, unprincipled, and unjust decisions. The suggested approach also would seem to appeal to the judiciary because it allows for a healthy amount of judicial subjectivism in the final decision.

VII. Conclusion

During the pre-*Sabbatino* era, the courts might have justified a general territorial limitation upon the Act of State Doctrine as it applies to expropriations on the basis that sitting in judgment of a foreign expropriation covering property in the United States would not offend the needs of international comity, a factor stressed by the Supreme Court in *Ricaud*. The New York State courts viewed the doctrine as inapplicable to extraterritorial acts, denying effect to Soviet decrees under state public policy or on the basis of what the author has concluded was an inappropriate analogy to private conflict of laws rules.

In *Sabbatino*, the Supreme Court redefined the rationale behind the Act of State Doctrine. Although several commentators have questioned the validity of a general territorial limitation after *Sabbatino*, that decision does not preclude such a limitation. Although American courts may scrutinize extraterritorial expropriations, the present standard of evaluation, that is, American public policy, is clearly deficient.

With few exceptions, American courts employing the public policy standard have denied effect to extraterritorial confiscatory decrees of foreign governments. According to American public policy, derived from the United States Constitution, there is no such thing as a good confiscation. Accepting such a general principle is difficult given the great number of reasons which may motivate a foreign state to confiscate property of its nationals and the various public and private interests which arise from case to case. Courts could avoid the drawbacks of the public policy approach by treating extraterritorial expropriation problems as extraordinary choice of law questions. The method of analysis, it is submitted, is furnished by section 6 of the *Restatement (Second) of Conflict of Laws*, which lists the most appropriate factors to be taken into account by the courts in determining the applicable law.

Computer Crime: The Law in '80

MICHAEL GEMIGNANI*

I. INTRODUCTION

Although various devices to speed numerical computations and the processing of data have existed for many centuries,[1] the electronic stored program, general purpose computer was not invented until the latter half of the 1940's.[2] The first computers were enormous, slow, and unwieldy devices compared to today's machines, dependent as they were upon bulky and inefficient vacuum tubes. The coming of transistors provided a major impetus to computer technology. Today, more efficient and exotic forms of "hardware" presage future computers that are smaller, faster and more powerful.[3]

There is scarcely anyone in the United States, no matter how poor or isolated, whose life is not touched significantly by computers. Now that there are rather powerful, general purpose computers which are sufficiently small, inexpensive, and easy to use to be practical for use at home,[4] and with electronic funds transfer looming on the horizon,[5] computers are certain to have an even greater impact on society in the future.

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*Chairman of the Mathematical Sciences Department, Indiana University-Purdue University at Indianapolis (IUPUI); Acting Chairman of the Computer Sciences Section, Indiana University-Purdue University at Indianapolis. A.B., University of Rochester, 1962; M.S. & Ph.D., University of Notre Dame, 1964 & 1965; J.D., Indiana University School of Law-Indianapolis, 1980.

The author expresses his gratitude to Associate Professor Henry Karlson for many helpful discussions.

[1]Perhaps the earliest computational device, apart from fingers, is the abacus, which is fully 5000 years old. For a short history of computing machines, see 4 ENCYCLOPEDIA BRITANNICA 1046-47 (1974). Useful texts include A. CHANDOR, A DICTIONARY OF COMPUTERS (1970); READINGS FROM SCIENTIFIC AMERICAN, COMPUTERS & COMPUTATION (1971); F. SCHEID, INTRODUCTION TO COMPUTER SCIENCE (1970); A. TANENBAUM, STRUCTURED COMPUTER ORGANIZATION (1976).

[2]The Princeton mathematician John von Neumann is generally credited with the invention of the stored program computer. 4 ENCYCLOPEDIA BRITANNICA 1047.

[3]Innovations may cause legal problems. For example, computer abuse legislation may be framed in terms of "electronic computers," but many computers of the future may not be electronic at all. *See* text accompanying notes 133-35 *infra*.

[4]Complete computer systems, including a wide variety of accessories, are available for less than $2000, and the price is almost certain to fall. A basic home computing system can be purchased for less than $1000.

[5]*See* R. FREED, COMPUTERS AND LAW 634 (1976). *See, e.g.*, FLA. STAT. ANN. § 659.062 (West Supp. 1979); IOWA CODE ANN. § 524.803 (West Supp. 1979-80); ME. REV. STAT. tit. 9-B, §§ 131(14), (35), 334 (West Supp. 1979).

Computers have brought about a revolution in our century comparable to the industrial revolution of the previous century. Just as the industrial revolution necessitated a rethinking of much of the law of its time, so too the computer revolution poses legal questions today that must be addressed and answered. This Article will attempt to explore a limited number of those questions as well as some suggested answers. The emphasis herein will be on computer "abuse," and, in particular, "crimes" which present special problems under existing law.

A. General Forms of Abuse Involving Computers

Donn Parker of the Stanford Research Institute, probably the foremost expert today on the technical aspects of computer abuse, classifies forms of abuse involving computers under four headings:[6]

1) The computer itself is an *object* of attack or some abusive act, as, for example, firing a bullet into a computer or bombing a computer center.[7] This form of abuse can almost always be treated under the standard law governing crimes or torts against property and generally presents no substantially new legal issues.[8]

2) The computer creates a unique *environment* for the abuse or forms the source of a unique type of asset. For example, someone familiar with the operating system of a particular computer might attempt to erase valuable files in the computer's memory, or cause the system to "crash,"[9] often with major inconvenience and expense to the computer operator and the user of the machine. Yet another example of this form of abuse occurs when one business infiltrates the computer system of a competitor in order to steal trade secrets

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[6]D. PARKER, CRIME BY COMPUTER 17-22 (1976). Parker summarized this classification in testimony before the Senate Subcommittee on Criminal Laws and Procedures in June 1978 when the subcommittee was considering S. 1766, the Federal Computer Systems Protection Act. *Federal Computer Systems Protection Act: Hearings on S. 1766 Before the Subcomm. on Crim. Laws & Proc. of the Senate Comm. on the Judiciary*, 95th Cong., 2d Sess. 56 (1978) (statement of Donn Parker) [hereinafter cited as *Hearings*].

[7]*See* D. PARKER, *supra* note 6, at 18 for accounts of four instances of assaults upon a computer with a gun. The most tragic episode, involving a bombing of a computer, resulted in the death of a graduate student at the University of Wisconsin. For an account of both this episode and the bombing of a Pentagon computer, see SENATE COMM. ON GOVERNMENT OPERATIONS, 94TH CONG., 2d SESS., PROBLEMS ASSOCIATED WITH COMPUTER TECHNOLOGY IN FEDERAL PROGRAMS & PRIVATE INDUSTRY 107 (Comm. Print 1976) [hereinafter cited as PROBLEMS].

[8]A fiction writer might come up with a plot involving a program which causes a computer to destroy itself. In actual practice, programs designed to cause trouble can only destroy, alter, or copy other data or programs, that is, they really affect software rather than hardware. This problem is discussed in the next section.

[9]*Hearings*, *supra* note 6, at 56.

or data which provide an edge in bidding on a contract. Abuses under this heading often present significant new legal questions.

3) The computer can be the *instrument* of the abuse. Crimes that might be classified under this heading range from murder perpetrated by causing a deliberate malfunction of a computer which governs a life support system[10] to the theft of computer time through the unauthorized use of a machine. Here again, novel legal issues may be presented.

4) A computer may be merely a *symbol* used in fraud, intimidation or other unsavory activity. Someone who falsely advertises that he is able to accurately predict the behavior of the stock market by means of a unique computer program, when he has no computer or computer program and is merely guessing what will happen, is indulging in this form of abuse. A collection agency which threatens a debtor by telling him that it will transmit his file from its computer to the computers of government agencies would be attempting to exploit the debtor's worst fears of what a computer can do. Despite the fact that the computer makes these practices possible, they do not generally raise significant new legal issues.[11] The computer is merely a tool of the tort or the crime.

B. The Computer

A computer is a machine which processes data.[12] What the computer does with data is determined by instructions given it by the user. Very simplistically, a computer may be thought of as a huge array of switches, each of which is either on or off. Some of the switches are set in accordance with the manufacturer's design of the computer. Other switches are set by the individual user according to the specific task he wants the computer to perform. The process of setting the switches is called "programming." Setting those switches which "bring the machine up" and prepare it to accept data and instructions from various users involves an "operating systems program." Once the machine is "up," a user then sets other switches to prepare the machine to do his particular job; generally, the user does this by means of an "applications program" written in one of the higher level computer languages such as FORTRAN or COBOL;

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[10]Destruction of life can also occur through misapplication of air traffic control computers and computers governing military weapons. *Id.* at 59.

[11]If someone actually has a computer, but no valid means of predicting the behavior of the stock market, the usual rules of law concerning fraud, deceit, negligence, and breach of warranty, would apply.

[12]The definition of a computer is not so obvious. *See* notes 151-53 *infra* and accompanying text.

such a program is called a "source program."[13] The fully programmed computer may be thought of as a machine especially designed to take the data given it by the user and process that data according to the directions embodied in the applications program.

Even though the computer is a machine, it is quite different from virtually every other machine previously known to mankind. In the first place, the computer works at speeds which defy the imagination. Even an extremely slow computer can perform tens of thousands of computations in a single second. The speed of a computer provides its real utility; there is nothing that a computer can do that cannot be done manually given enough manpower and enough time. But the computer can compress man-years of work into minutes and digest libraries of information at virtually the speed of light.

A second important aspect of a computer is that each time it is used, it is, in effect, redesigned internally. The internal design, however, is often impossible to observe and difficult to check. Both the operating systems program and the source program for some particular job may be so complex that no human being could reasonably check the accuracy of each and every switch setting to be certain that the computer was properly prepared to do the task that the user set for it, even assuming that the programs themselves are logically correct and stated in a form that will lead the machine to produce the intended result. Furthermore, the switches of a computer are not like lightbulbs; one cannot tell if they are on or off by simply looking at them; indeed, most of them are too small to be seen with the naked eye.

Consider a black box within which is a small genie who will answer any question asked provided it is posed in exactly the right way. Someone who has a particularly difficult question tries very hard to phrase it in precisely the form that the genie will understand. The dilemma is compounded by the fact that the genie will always provide an answer when asked any question, even questions which are improperly worded. After a great deal of hard work, the questioner places his question in a slot at one end of the box and receives an answer from a slot at the other end. He receives the answer to his question if it was entered in exactly the right form; otherwise, what he receives is worthless. What credence should he place in the answer? This parable illustrates but one of the many problems associated with the use of computers.

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[13]A source program is written in a high-level language such as FORTRAN (Formula Translation) or BASIC (Beginner's All-purpose Symbolic Instruction Code). This source program is translated inside the computer by means of a "compiler" into an object program written in machine language which actually sets the switches.

C. *Abuses Peculiar to Computers*

Some of the forms of abuse peculiar to computers are beginning to take shape. For example, the incredible speed coupled with the vast quantities of data processed can enable small crimes to pay rich dividends. One form of theft by computer is known as the "salami technique." This involves taking a small amount, like thin slices of a salami, from a large number of sources. The computer of a large bank may handle tens or hundreds of thousands of accounts.[14] The perpetrator of a theft employing the salami technique would arrange for the computer to transfer very small amounts of money from randomly selected accounts into an account which he controls. Only $.10 may be transferred in a given month from any one account, and the number of accounts affected at any one time would be but a fraction of the total accounts the bank services, but the overall amount of money siphoned off would be sizable.

Banks usually find it more convenient simply to credit an account alleged to be short $.10 if a customer complains; and, of course, most customers will simply assume that they made some error, write off the loss when reconciling their checkbooks, and never notify the bank at all. The small patch of program which effects the transfers will probably be skillfully concealed in an enormously large and complex program or made a part of the operating system of the computer, thus defying easy detection.

Because the perpetrator in this case would presumably have access to, and intimate knowledge of, the bank's computer system, he could destroy or modify the program as necessary if he found that a detailed audit was about to take place. In actual fact, however, the bank would almost certainly find it cheaper to just pay the small sums and not even conduct the time-consuming and expensive investigation needed to confirm that a theft was taking place. Note that the theft takes place at high speeds and totally automatically, untouched by human hands and unseen by human eyes. Such a scheme would be totally impractical, or at least much more risky and much less profitable, if the perpetrator had to transfer such amounts manually and personally keep all of the records in balance.

D. *Difficulties in Prosecution*

The blunt fact is that few prosecutions ever result from computer crime. Even the scope of the problem is not entirely clear. Donn Parker in his exhaustive study of computer abuses has found

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[14]For an account of a theft using the salami technique, see *Hearings*, *supra* note 6, at 62-63.

only several hundred cases, and not all of these have been confirmed.[15] Many of the instances found by Professor Parker do not involve abuse integrally linked to the special characteristics of a computer.[16] Nevertheless, the average loss per instance of computer abuse, not counting the massive Equity Funding caper,[17] is $450,000,[18] more than five times the amount of the average loss sustained in 1971 from more traditional embezzlement schemes.[19] Obviously, any single computer-aided swindle can result in the loss of billions of dollars. Considering the prevalence of computers[20] and the apparent opportunities for improper gain, there are surprisingly few reported cases of computer crime. Many computer systems have significant crosschecks, audit trails, and other safeguards which serve to deter abuse, or at least make it more difficult, but even in cases where a thief has been caught red-handed, employers have often been unwilling, for various reasons, to prosecute. First, there is the embarrassment that an employer would suffer from publicly acknowledging that someone has cheated him and his customers using his own, supposedly reliable, computer. Second, many prosecutors and judges do not like to handle cases involving computers for the same reason that many students avoid mathematics courses: they simply do not understand them. For example, there is the problem of effecting a search of a computer even with a valid warrant.

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[15]D. PARKER, *supra* note 6, at 23-40. For an extensive study of computer abuses within government, see PROBLEMS, *supra* note 7, at 76-117. A moderate litany of computer abuses is recited in J. CARROLL, COMPUTER SECURITY (1977). The number of reported cases involving computer abuse, however, is miniscule.

[16]Of the cases which Parker found, 37% fall under headings 1 and 4 which generally do not involve new questions of law. *See* note 6 *supra* and accompanying text. Of course only a fraction of the cases under the other headings will actually involve novel legal issues.

[17]*See* D. PARKER, *supra* note 6, at 118-74. Certain officers of Equity Funding created fictitious insurance policies and sold them at a discount to other insurers. They paid the premiums to the purchasers of the bogus policies from premiums on legitimate policies they held for Equity. The scheme collapsed when the income from real policies could not meet the increasing obligations generated by the bogus ones. There is some question whether this was really a computer crime, but there is no doubt that it would have been impossible without the capability of computers for processing large amounts of information.

[18]D. PARKER, *supra* note 6, at 28.

[19]*Id.* at 32.

[20]In 1977, the government had more than 10,000 computers in use. STAFF OF SENATE COMM. ON GOVERNMENT OPERATIONS, 95TH CONG., 1ST SESS., STAFF STUDY OF COMPUTER SECURITY IN FEDERAL PROGRAMS 6 (Comm. Print 1977) [hereinafter cited as SECURITY]. In 1977, there were some 500,000 computer systems made by American-based companies in use throughout the world; it is estimated that there will be some 1,100,000 such computers in use in 1981. Amicus curiae brief for CBEMA at 17-18, Parker v. Flook, 437 U.S. 584 (1978).

There is simply nothing that can be seen by observing the computer itself that would provide any evidence against an embezzler. The prosecutor would have to bring along a team of computer experts familiar with the machine who could "dump" the files and then interpret them.[21] Furthermore, the clever programmer who is stealing a fortune in nickels and dimes seems far less a danger to society than violent criminals. In some instances, computer criminals fired for dishonesty from one job go right into another position of even higher trust and responsibility. Others have been hired at large salaries as security consultants to help catch less clever crooks.[22]

The technology of computers is changing so rapidly that the fast and efficient machines of today will soon seem as unwieldy and slow as the machines of two decades ago seem today.[23] With more powerful machines come better opportunities for security, but also more exotic opportunities for abuse. Because human beings remain the architects of all phases of computer operations, at least in their initial phases, it is doubtful that a theftproof system can ever be devised. With the advent of electronic funds transfer and increased intercommunication among computers, the potential for theft on a truly majestic scale will be more of a temptation than many experts will be able to resist.

This Article will examine the legal weapons available for use against computer criminals, including a brief summary of existing state and federal law, a consideration of the few reported cases involving computer abuses, and a discussion of new and proposed legislation addressed specifically at computer abuse. The Article will conclude with a review of the situtation in Indiana, including a recent trial in Marion County involving a fascinating instance of computer crime, and a proposal for statutory revisions aimed at controlling computer crime.

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[21]For an account of a case in which such a search was conducted, see D. PARKER, *supra* note 6, at 85-96. For a copy of the search warrant itself and the property receipt, see R. FREED, COMPUTERS & LAW 483-84 (5th ed. 1976) [hereinafter cited as FREED].

[22]The most notorious example in this regard is Jerry Schneider, who used Pacific Telephone and Telegraph Company's computer to rob it of equipment. The total take may have been in the millions. Jerry might never have been caught if he had not been turned in by a disgruntled employee. He served 40 days and paid a $500 fine. He had to repay the telephone company some $8500, but he is making more than $100,000 per year now as a security consultant. His story is told in D. PARKER, *supra* note 6, at 59-70.

[23]Semiconductor technology is progressing so rapidly that the cost of computation is decreasing by a factor of 10 every 5 years. Sugarman, *On Foiling Computer Crime*, INST. OF ELECTRICAL & ELECTRONIC ENGINEERS. SPECTRUM, Jul. 1979, at 31, 33.

II. Existing State and Federal Laws

A. Previous Surveys

At least two in-depth studies have been made concerning existing state laws that might be used to combat computer abuse. One of these reports was written by Ms. Susan Nycum as part of a study of Infonet[24] sponsored by the General Services Administration.[25] Ms. Nycum's legal analysis appears both in a Senate committee print[26] and, in a somewhat expanded form, in a law review article.[27] Though it deals with most forms of computer abuse, it surveys the legislation of only eleven "computer intensive" states.[28]

Mr. David Bender published an exhaustive study in 1970 concerning trade secret protection of software.[29] An updated, but less comprehensive, version of his important work appeared in 1977.[30] The entire field of computer law is changing quite rapidly so that any survey of legislation and case law concerning computers is likely to be at least partially obsolete by the time it appears.[31] For example, at least two states have already passed statutes dealing explicitly with computer-related crime,[32] but none of this specialized legislation is dealt with in either study. A further *caveat* that must be observed in dealing with state statutory and common law is that generalizations are often impossible, or at least somewhat risky, because each state has its own distinctive interpretation of what the law is within its borders.

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[24]Infonet is the largest administrative data processing (ADP) firm supplying such services to the government. There was some concern for the security of the system because certain inmates at Leavenworth Prison had access to the system. The prisoners were working under a contract with the Internal Revenue Service.

[25]The report was done under the general direction of Donn Parker of the Stanford Research Institute. Ms. Nycum is a partner in a San Francisco law firm, a collaborator with Mr. Parker in studies involving law and computers, and one of the nation's foremost experts in computer law.

[26]Security, *supra* note 20, at 195.

[27]Nycum, *The Criminal Law Aspects of Computer Abuse: Part I: State Penal Laws*, 5 Rutgers J. of Computers & L. 271 (1976).

[28]California, Delaware, the District of Columbia, Florida, Illinois, Massachusetts, New Jersey, New York, Pennsylvania, Texas and Virginia. *Id.* at 271.

[29]Bender, *Trade Secret Protection of Software*, 38 Geo. Wash. L. Rev. 909 (1970).

[30]Bender, *Trade Secret Software Protection*, Computer L. Serv. § 4-4, Art. 2 (1977).

[31]By way of example, Indiana, which had no trade secret statute at the time Mr. Bender wrote his article, passed such a statute even before the article appeared in print. Ind. Code §§ 35-17-31-1 to -5 (1976, repealed 1977). Recently, Indiana repealed that statute in favor of one which includes trade secrets in a list of items which can constitute the *res* of larceny. *Id.* § 35-41-1-2 (Supp. 1979). Despite this legislative activity, Indiana seems to have no reported cases dealing with theft of trade secrets.

[32]Ariz. Rev. Stat. Ann. § 13-2316 (1979); Fla. Stat. Ann. §§ 815.01-.06 (1978).

Ms. Nycum has also prepared a complete survey of existing federal legislation that might be used to prosecute computer criminals.[33] As is the case with state legislation, only a handful of statutes have ever actually been used to prosecute anyone for a computer-related crime, so much of what can be done with these statutes remains conjectural. New federal legislation addressed specifically to computer crime has been introduced by Senator Abraham Ribicoff;[34] this proposed statute will be discussed later in this Article.

The use of federal penal statutes requires a basis for federal jurisdiction. Because this Article is focused on abusive acts rather than jurisdictional issues, this question will not be pursued herein, but it is, of course, something that must be considered in any potential prosecution.[35] In certain instances, state legislation is assimilated into the federal criminal code, thus permitting federal prosecutions which would have been questionable under the federal statutes alone.[36]

B. Theft

Traditional forms of offenses against tangible property can almost always be dealt with without difficulty under existing law, even if a computer is somehow involved in the offense. If someone fires a bullet into a computer or burns down a computer center, there are no special legal problems presented. Difficulties in coping with computer abuse arise because much of the property involved does not fit well into categories of property subject to abuse or theft; a program, for example, may exist only in the form of electric

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[33]Nycum, *The Criminal Law Aspects of Computer Abuse, Part II: Federal Criminal Code*, 5 RUTGERS J. OF COMPUTERS & L. 297 (1976).

[34]The Federal Computer Systems Protection Act of 1979, S. 240, 96th Cong., 1st Sess., 125 CONG. REC. S645 (Jan. 25, 1979). The predecessor of S. 240 was S. 1766. *See* note 6 *supra*.

[35]*See* Nycum, *supra* note 33, at 298.

> The traditional method of defining federal criminal offenses not based upon . . . territorial jurisdiction or clearly devoted to the direct vindication of some weighty federal interest . . . has been to authorize federal punishment not for the familiar types of wrongdoing themselves but for the use of federal channels in connection with such wrongdoing.

Levine, *The Proposed New Federal Criminal Code: A Constitutional and Jurisdictional Analysis*, 39 BROOKLYN L. REV. 1, 9 (1972).

[36]18 U.S.C. § 13 (1976) extends state law into various territories located within a state but otherwise exclusively subject to federal jurisdiction. These areas of special jurisdiction are listed in 18 U.S.C. § 7 (1976). The most important area is the federal enclave, that is, land acquired by the federal government with the consent of the state legislature for use in certain federal areas of concern, such as the construction of a fort.

impulses or a magnetic pattern on a tape. Also, even when a program of substantial commercial value is misappropriated, the person from whom it is "stolen" almost always remains in possession of the original.[37] Indeed, the original program may not have been moved so much as a single inch while being illicitly copied. It may be duplicated exactly via electronic signals over a telephone line from one computer to another without altering the original program in any way, even while the original is actually running.

The principal reason someone might wish to steal a computer program is to save the time, trouble and expense of writing the program himself. Computer programs can, of course, be both long and complex;[38] they may take months, or even years, to write and "debug."[39] Because it is uncertain presently whether programs can be validly copyrighted or patented,[40] and because, even if they can be, these traditional forms of protection are not well suited to computer technology, the most effective source of protection for valuable software is statutory and common law trade secret protection.[41]

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[37]By using "trapdoor" or "Trojan Horse" techniques, a skilled computer thief can even cause a proper use of a program to be the trigger for its illicit and automatic transfer to his own control. In addition to more prosaic methods of copying programs such as photography and various copy processes, there are more exotic methods such as using the electromagnetic waves generated by a computer to "tap" its contents. *See, e.g.*, Sugarman, *supra* note 23, at 32.

[38]For example, the SABRE program employed by American Airlines in making plane reservations contains more than one million instructions and cost more than $30 million to produce. Burck, *"On Line" In "Real Time,"* FORTUNE, Apr. 1964, at 145.

[39]"Debugging" is the process of removing errors from a draft program. A computer is very unforgiving of mistakes; one misspelled word or a single misplaced comma in a program may cause the program to fail (not run at all), or to give an incorrect result. Debugging may be more arduous than writing the program in the first place.

[40]Although the Copyright Office accepts computer programs for copyright under a general policy of accepting anything for registration that might be copyrightable, there is a serious question whether such a copyright would hold up if challenged. Even if it is valid, it is not clear what real protection it confers. Patents are even more problematic. For recent and fairly comprehensive treatments of this complex question, see Davis, *Computer Programs and Subject Matter Patentability*, 6 RUTGERS J. OF COMPUTERS & L. 1 (1977); Gemignani, *Legal Protection for Computer Software: The View from '79*, 7 RUTGERS J. OF COMPUTERS, TECHNOLOGY & L. 269 (1980); Bigelow, *Copyrighting Programs—1978*, [1978] 3 COMPUTER L. SERV. § 4-3 Art. 4; Ross, *The Patentability of Software and Firmware*, [1978] 3 COMPUTER L. SERV. § 4-2, Art. 5.

[41]In the 1960's, the fear arose that federal law had preempted state trade secret law. This fear was based upon Supreme Court decisions in Lear, Inc. v. Adkins, 395 U.S. 653 (1969); Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234 (1964); and Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225 (1964). More recent decisions have made it clear that the Court still recognizes the validity of state trade secret protection. *See* Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974); Goldstein v. California, 412 U.S. 546 (1973).

There is no federal trade secret legislation, although the need for such legislation has been recognized.[42] Nor does every state have trade secret legislation. Even in those states which do have such laws, misappropriation of a trade secret may not rise to the level of a crime. When a trade secret is taken, the form of the taking is often critical in determining whether prosecution is possible. This point will be dealt with in the sections below.

1. State Larceny Statutes.—In some instances, theft of computer programs is punishable as larceny. Common law larceny is the "felonious taking and carrying away of the personal property of another with intent to deprive the owner of his property permanently."[43] Special problems arise in applying this definition to misappropriation of computer programs with respect to the nature of the property taken, whether the property is carried away, and whether the owner is "permanently" deprived of something he retains possession of after his program is illicitly copied. Although many states by statute have altered the common law notion of larceny, one or more of these problems may still remain because statutory interpretation often involves application of common law principles.

Ms. Nycum believes that there are but two instances in which theft of a program may not be prosecutable as larceny.[44] The first occurs when the actor copies the program onto his own materials, for example, film, paper, or cards, but does not carry off the original.[45] In this instance, the original program is never brought under the direct or indirect control of the actor, and may not even be touched.[46] An indictment for larceny may also fail if the only thing taken is something as intangible as electronic impulses.[47] As Mr. Bender observed: "The nature of the entity which must be taken in order to constitute the crime is critical, and the precise wording and interpretation of the statute in question will determine whether the taking of a trade secret may constitute larceny."[48]

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[42]*See, e.g.*, Keefe & Mahn, *Protecting Software: Is It Worth All the Trouble?*, 62 A.B.A.J. 906, 906-07 (1976).

[43]Fletcher v. State, 231 Md. 190, 192, 189 A.2d 641, 643 (1963), *quoted in* Bender, *supra* note 29, at 942.

[44]Nycum, *supra* note 27, at 275.

[45]Even though the act may not be prosecutable in some jurisdictions, it may be in others, particularly those in which the subject matter of larceny is anything of value. *See, e.g.*, IND. CODE § 35-43-4-2 (Supp. 1979).

[46]*See* note 37 *supra* and accompanying text.

[47]*See* Ward v. Superior Court, 3 COMPUTER L. SERV. REP. 206 (1972), *discussed at* text accompanying notes 67-72 *infra*.

[48]Bender, *supra* note 29, at 942.

Mr. Bender divides the fifty states and the District of Columbia into four groups according to the kind of property which can be the res of larceny or theft of a trade secret. The first group consists of those states which "follow the common law definition in defining the res as property, or by using some like phrase."[49] Mr. Bender offers little guidance as to what would happen concerning any purported theft of a trade secret in those states.[50]

Other states, those making up the second group, modify or extend the notion of property by providing lists which indicate what is to be considered "property."[51] Because laws dealing with criminal acts are to be interpreted strictly, the usual reading of these statutes would indicate that if a certain object could not be placed among the listed items, that object could not be the subject matter of theft.

The third group of jurisdictions is composed of those which hold the res of larceny to a "thing of value."[52] Computer programs ob-

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[49]*Id.* Because Bender cites no authority for his conclusion, it is difficult to know how he arrived at it. A check of current state statutes dealing with theft and the definition of property relative thereto seems to reduce the list to two jurisdictions, Alaska and Idaho. ALASKA STAT. § 01.10.060(8) (1972); IDAHO CODE § 18-4601 (1972). *But see* IDAHO CODE § 55-102 (1972).

[50]There is so little case law in this area that speculation on the outcome of future cases is futile.

[51]Bender lists the following states: Alabama, Alaska, Arizona, Connecticut, Delaware, Iowa, Mississippi, Nevada, North Dakota, Rhode Island, South Carolina, South Dakota, Texas, Vermont, Washington, West Virginia, and Wyoming. Bender, *supra* note 30, at 15 n.53. According to a more recent search of the statutes, "list" state statutes include MASS. GEN. LAWS ANN. ch. 266, § 30 (West Supp. 1979); MICH. GEN. LAWS ANN. § 750.10, .356 (1968); MISS. CODE ANN. § 1-3-41 (1972); NEV. REV. STAT. § 193.010 (1973); N.C. GEN. § 12-3 (1969); OKLA. STAT. ANN. tit. 21, § 103 (1958); R.I. GEN. LAWS § 11-41-1 (1970); S.C. CODE § 16-13-30 (1977); VT. STAT. ANN. tit. 13, § 2501 (1974); W. VA. CODE § 2-2-10 (1979); WIS. STAT. ANN. § 943.20 (West 1958 & Supp. 1979-80). In addition, a number of states use both a list and a definition of property as a "thing of value," or the like. Relevant statutes include: ARK. STAT. ANN. § 41-2201 (1976); GA. CODE ANN. § 26-401 (1978); HAWAII REV. STAT. § 708-800 (1976 & Supp. 1978); ME. REV. STAT. ANN. tit. 17A, § 352 (1979); MINN. STAT. ANN. § 609.52 (Supp. 1979); MONT. REV. CODES ANN. § 94-2-101 (1974 & Supp. 1977); N.H. REV. STAT. ANN. § 637:2 (1964 & Supp. 1973); N.Y. PENAL LAW § 155.00 (McKinney Supp. 1979-80); N.D. CENT. CODE § 12.1-23-10 (1960 & Supp. 1979); S.D. COMP. LAWS ANN. § 22-1-2 (1979); TEX. PENAL CODE ANN. tit. 7, § 31.01 (1974 Vernon); WYO. STAT. § 6-1-101 (1977).

Arizona has recently passed special legislation specifically addressed to computer crime. ARIZ. REV. STAT. ANN. § 13-2310(E) (1978). *See* text accompanying notes 157-61 *infra*. Prosecution for the same criminal act can, of course, often be pressed under more than one statute.

[52]The jurisdictions listed by Bender include the District of Columbia, Florida, Hawaii, Kansas, Louisiana, Maryland, Missouri, Montana, and Virginia. The exact phrase "thing of value" is not necessarily used in all of these jurisdictions, but Bender believes the respective phrases used are similar enough to mean the same things. Once again, Bender gives no authority. A search of statutes seems to indicate that "thing of

viously fit rather well under this rubric. Mr. Bender notes two problems which must be addressed not only in "thing of value" jurisdictions, but in those in the first two groups as well. The first problem arises when something is taken without an intent of permanently depriving its owner of possession, for example, when it is taken with the intent of replacing it after a copy has been produced. The intent to return, or the actual return of the object taken, may, in some jurisdictions preclude a charge of larceny, or might require that a lesser charge be filed. A second problem is establishing the value of the item taken. In *Hancock v. Texas*,[53] the value assigned to a set of misappropriated copies of programs was their commercial value as evidenced by expert testimony, but the defendant was prosecuted under a trade secret statute and not under the Texas larceny statute. If the value of the thing stolen is taken to be the value of the underlying material object, for example, the computer paper on which the program is printed, then someone stealing a program having a commercial value in the millions of dollars might be chargeable with only a trivial offense.

In addition to the two problems cited above, there is also the problem of the manner of theft. If the actor fails to make off with the program, or even move it, he has not deprived the owner of its possession, even for a brief moment. If the actor relies only on electronic signals, he may not have even made a tangible copy of the program. Of course, someone who misappropriates a copy of a program has by his action deprived the owner of something, specifically, the secrecy attached to the program as well as the potential commercial gain that might have been realized through the sale or licensing of the program. But not all courts would be willing to recognize secrecy or potential gain as property capable of being

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value" is actually used in the following: ALA. CODE § 13A-8-1(10) (Supp. 1979); ARIZ. REV. STAT. ANN. § 13-105(27) (1956 & Supp. 1978); COLO. REV. STAT. § 18-4-401 (1973 & 1978 Repl.); CONN. GEN. STAT. ANN. § 53a-118(1) (West 1972); DEL. CODE ANN. tit. 11, § 877(4) (1974); D.C. CODE ENCYCL. § 22-2201 (West 1967); FLA. STAT. § 812.012(3) (1976 & Supp. 1979); ILL. REV. STAT. ch. 38, § 15-1 (1973); IND. CODE § 35-41-1-2 (1979); IOWA CODE § 702.14 (1976 & Supp. 1978); KAN. STAT. ANN. § 21-3110 (Supp. 1979); KY. REV. STAT. § 514.010(5) (1975); LA. REV. STAT. ANN. § 14:67 (West 1974); MD. ANN. CODE art. 27 § 340(h) (Supp. 1979); MO. ANN. STAT. § 570.010 (Vernon 1979); NEB. REV. STAT. § 28-509 (1943 & Supp. 1978); N.J. STAT. ANN. § 2c:20-2(g) (West Supp. 1979); N.M. STAT. ANN. § 30-16-1 (1978); OHIO REV. CODE ANN. § 2901.01 (Page 1975); OR. REV. STAT. § 164.005(5) (1979); 18 PA. CONS. STAT. ANN. § 3901 (Purdon 1972); TENN. CODE ANN. § 39-4201 (1975); TEX. PENAL CODE ANN. tit. 7, § 31.01 (Vernon 1974); UTAH CODE ANN. § 76-6-401(1) (1978); VA. CODE § 18.2-95 (1975); WASH. REV. CODE ANN. § 9A. 04.110(21) (1974). In addition, a number of statutes used both a list and "thing of value" to characterize property subject to theft. *See* note 49 *supra*.

[53]402 S.W.2d 906 (Tex. Crim. App. 1966), *aff'd sub nom.* Hancock v. Decker, 379 F.2d 552 (5th Cir. 1967).

stolen, though interference with these rights may well form the basis for an action in tort.

The case of *Lund v. Commonwealth*[54] is instructive. Charles Lund, a doctoral student at Virginia Polytechnic Institute and State University (VPI), was convicted of grand larceny for use of VPI's computer without proper authorization. Lund's thesis research required the use of the computer, but, through an oversight, his advisor failed to provide an account for him. Lund began using accounts assigned to other persons and departments without their permission. The director of VPI's computer center estimated that by the time Lund was caught, he may have used as much as $26,384.16 in unauthorized computer time. The director also admitted that the value of the cards and paper obtained from Lund was "whatever scrap paper is worth."[55]

Lund admitted that he used the computer without specific authority, but he and four faculty members, including his department chairman and advisor, testified that the work was for his thesis and he would have been given authorization had he requested it. Lund appealed his conviction on the grounds that there was no evidence that the articles in question were stolen, or that they had a value of $100 or more, and, in any case, computer time and services were not the subject of larceny.

One of the Virginia statutes in question provided:

> Any person who: (1) Commits larceny from the person of another of money or other thing of value of five dollars or more, or
>
> (2) Commits simple larceny not from the person of another of goods and chattels of the value of one hundred dollars or more, shall be deemed guilty of grand larceny . . . .[56]

Another statute stipulated: "If any person obtain, by any false pretense or token, from any person, with intent to defraud, money or other property which may be the subject of larceny, he shall be deemed guilty of larceny thereof . . . ."[57]

The court found that "[a]t common law, labor or services could not be the subject of the crime of false pretense because neither time nor services may be taken and carried away."[58] Even though some states had amended their criminal codes to make obtaining

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[54]217 Va. 688, 232 S.E.2d 745 (1977).

[55]*Id.* at 690, 232 S.E.2d at 747.

[56]*Id.* at 690, 232 S.E.2d at 747 (quoting VA. CODE § 18.100 (1950) (currently codified at VA. CODE § 18.2-95 (1975))).

[57]*Id.* at 690, 232 S.E.2d at 747 (quoting VA. CODE § 18.1-118 (1950) (currently codified at VA. CODE § 18.2-178 (1975))).

[58]217 Va. at 692, 232 S.E.2d at 748.

services by false pretenses a crime,[59] Virginia had not done so. Also, the unauthorized use of a computer was found not to be the subject of larceny because it did not involve the "taking and carrying away of a certain concrete article of personal property."[60] The court also would not accept the Commonwealth's argument that the value of the print-outs should be measured by the cost of production. The court concluded that where there is no market value for an article that has been stolen, the prosecution must prove its value.[61] The print-outs had no ascertainable value to VPI or the computer center. Lund's conviction was reversed and the indictment quashed.[62]

2. State Trade Secret Legislation.—A group of states have passed legislation which deals specifically with trade secrets. At the time of Mr. Bender's first survey,[63] eighteen states had passed such legislation; six years earlier none had.[64] By the time of his updated article in 1977,[65] twenty-one states had such legislation.[66] The fact

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[59]See, e.g., N.Y. PENAL CODE § 165.15 (McKinney, Supp. 1979-80); N.J. REV. STAT. § 2A:111 (1969) (currently codified at N.J. REV. STAT. § 2C:208 (Supp. 1979)); CAL. PENAL CODE § 487 (West 1970).

[60]217 Va. at 692, 232 S.E.2d at 748.

[61]*Id.*

[62]*Id.* at 693, 232 S.E.2d at 749. The result in this case seems entirely just and reasonable, but suppose Lund had been playing "Startrek" instead of working on his thesis, or using the VPI computer for private gain, perhaps doing other students' programming assignments for pay?

[63]Bender, *supra* note 29.

[64]*Id.* at 947 n.200.

[65]Bender, *supra* note 30.

[66]Bender lists Arkansas, California, Colorado, Georgia, Illinois, Indiana, Maine, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Tennessee and Wisconsin, finally citing some authority for his statements. Specific statutes are listed in Bender, *supra* note 30, at 17 nn.64-67. The state law is often difficult to classify. The situation in Indiana illustrates this point. In 1969 the Indiana General Assembly added §§ 35-17-3-1 to -5 to the Indiana Code. These statutes described theft or embezzlement of an article representing a trade secret as well as copying an article representing a trade secret. They required an intent to deprive the owner of the secret of its control, or an intent to appropriate the secret to the actor's use or to the use of a third party. Return or intent to return was no defense. Nevertheless, in these statutes, the definitions of "article" and "copy" both implied some tangible object. In the 1976 revision of the criminal code, this separate chapter dealing with trade secrets was repealed, and trade secrets were incorporated into the definition of "property" listed in IND. CODE § 35-41-1-2 (Supp. 1979). Although § 35-41-1-2 describes property as "anything of value," it also names various types of property with some specificity. Thus, there is an ambiguity as to whether the specific is intended to prevail over the general inasmuch as there are articles which have value which do not seem to fit under any of the headings. In accordance with the usual strict interpretation of criminal statutes, it would seem that the more restrictive meaning of property should govern. But, by the

that a state has a statute which makes criminal a misappropriation of a trade secret does not preclude prosecution under other laws, such as the larceny statute, for the same offense.

As one might expect, California and New York, because of their size and the complexity of their technology and industry, have trade secret statutes. California, in fact, has one of the most detailed such statutes in the nation.[67] This statute provides in part:

> (b) Every person is guilty of theft who, with intent to deprive or withhold from the owner thereof the control of a trade secret, or with an intent to appropriate a trade secret to his own use or to the use of another, does any of the following:
>
> (1) Steals, takes, or carries away any article representing a trade secret.
>
> (2) Fraudulently appropriates any article representing a trade secret entrusted to him.
>
> (3) Having unlawfully obtained access to the article, without authority makes or causes to be made a copy of any article representing a trade secret.
>
> (4) Having obtained access to the article through a relationship of trust and confidence, without authority and in breach of the obligations created by such relationship makes or causes to be made, directly from and in the presence of the article, a copy of any article representing a trade secret.[68]

The statute further proscribes conspiracy to obtain a trade secret,[69]

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doctrine of plain meaning, it could also be argued that the list of objects is merely illustrative and not exhaustive. Which Bender category fits Indiana? Is Indiana a "thing of value" state, one which has a list, or one which has specific legislation addressed to trade secrets by virtue of its listing trade secrets explicitly in its criminal code? There is now some guidance in this area because of the *Thommen* case which is discussed later.

The law in Indiana concerning valuation of property and the sort of asportation required to sustain a conviction for theft is also unclear. In Warnke v. State, 89 Ind. App. 683, 167 N.E. 138 (1929), the conviction of an inept chicken thief who fled the coop leaving his bag of chickens behind was upheld. *Id.* at 686, 167 N.E. at 139. Early Indiana cases indicate that the collective value of all items stolen may be totaled to make the actor liable for larceny of a higher degree than he would have been for the theft of any individual item. *E.g.*, Edson v. State, 148 Ind. 285, 47 N.E. 625 (1897). Concerning value, the new Indiana Criminal Code requires only that whatever is taken have some value. IND. CODE § 35-41-1-2 (Supp. 1979). The extent of the value may not have to be proved. *See* text accompanying note 178 *infra*.

[67] CAL. PENAL CODE § 499c (West 1970 & Supp. 1979).

[68] *Id.* § 499c(b).

[69] *Id.* § 499c(c).

and explicitly declares that the return or intent to return the article representing the trade secret is not a defense.[70]

Despite its precision and comprehensiveness, the California statute leaves possible loopholes for the computer thief because both "article" and "copy" as defined elsewhere in the statute seem to refer only to tangible objects.[71] Furthermore, even though the conspiracy portion of the statute may cover a situation where an employee memorizes a program, copies outside his place of employment what he has memorized, and then delivers it for consideration to a third party, the law does not seem to forbid the employee from using the memorized program for his own personal benefit.[72]

Theft of a trade secret may also be prosecuted under the California larceny statute.[73] Even though the larceny statute does not explicitly state that trade secrets may be the object of larceny, California case law indicates that prosecution for theft of a trade secret may be maintained under the larceny statute provided that the secret is represented by some tangible object which has been carried away.[74] The valuation used is the commercial value and not the intrinsic value of the underlying object.[75]

In *Ward v. Superior Court*,[76] Ward, an employee of a computer service bureau,[77] used a telephone to transfer a secret program from a competitor's computer to that of his employer. He then caused his employer's computer to print a copy of the stolen program, which he carried to his office.[78] He was charged under both the trade secret[79] and grand theft statutes[80] of California. The court found that the

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[70]*Id.* § 499c(d).

[71]For example, "article" is defined as "any object, material, device or substance or copy thereof, including any writing, record, recording, drawing, sample, specimen, prototype, model, photograph, micro-organism, blueprint or map." *Id.* § 499c(a).

[72]*See* Bender, *supra* note 29, at 947-50.

[73]CAL. PENAL CODE § 484a (West 1970).

[74]People v. Dolbeer, 214 Cal. App. 2d 619, 29 Cal. Rptr. 573 (1963). *Dolbeer* involved a prosecution under the larceny statute for theft of lists of telephone subscribers. It was important to the court that some tangible object was taken. Indeed, the court stated that had the lists been merely copied in some manner, but not carried off, the prosecution could probably not have been upheld. *Id.* at 623, 29 Cal. Rptr. at 575.

[75]*Id.* at 622-24, 29 Cal. Rptr. at 574-75.

[76]3 COMPUTER L. SERV. REP. 206 (1972).

[77]A computer service bureau is a firm which supplies computer services, including actual machine use, to its clients.

[78]In doing so, Ward fraudulently used another client's account number. It appears that charges were not pressed on these grounds. If the client whose number was used actually incurred charges due to the fraudulent use, Ward might have been prosecuted for theft from, or fraud upon, that party as well. 3 COMPUTER L. SERV. REP. at 210.

[79]CAL. PENAL CODE § 499c(b) (West 1970 & Supp. 1979). *See* text accompanying note 68 *supra*.

[80]*Id.* § 487.

"article" taken must be tangible, "even though the trade secret which the article represents may itself be *intangible*."[81] Although the electronic impulses representing the stolen program were not sufficiently tangible to constitute an article of theft,[82] Ward had gone beyond merely transferring electronic impulses from one computer to another. His act of making a tangible copy of the program and then carrying the copy even the short distance to his office sufficed to establish the elements necessary for prosecution. Furthermore, merely making the copy in itself was a violation of the trade secret statute.[83] The court also concluded that the enactment of the trade secret statue made a trade secret property which is subject to theft. Therefore, a misappropriation of any trade secret, or article representing a trade secret, can also be charged as a theft of property under the larceny statute.[84] The lesson for potential computer thieves, at least in California, is that they should not make tangible copies of the programs they steal. If Ward had merely transferred the competitor's program to his computer and used it, possibly to his great profit, without bothering to print it, he might not have been subject to prosecution.

The New York larceny statute includes both trade secrets and "secret scientific materials."[85] Copying is itself an offense prosecutable apart from, or in addition to, stealing.[86] New York also appears to have a very broad notion of property which may be subject to theft.[87] A New York court described a prior, similar statute as follows: "It is difficult to conceive a definition more comprehensive than this, for it includes intangible property, as well as tangible, written instruments, as such, and everything, except real property, that is capable of being owned or transferred."[88] New York seems to follow the same valuation rule as California and Texas, that is, the commercial value of the object taken governs.[89]

3. Model Penal Code.—The Model Penal Code has virtually as broad a definition of property as does New York,[90] but the notion of

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[81]3 COMPUTER L. SERV. REP. at 208.

[82]*Id.*

[83]CAL. PENAL CODE § 499c(b)(3) (West 1970 & Supp. 1979). *See* note 68 *supra* and accompanying text.

[84]3 COMPUTER L. SERV. REP. at 210-11.

[85]N.Y. PENAL LAW § 155.30(3) (McKinney 1975).

[86]Nycum, *supra* note 27, at 279.

[87]N.Y. PENAL LAW § 155.00(1) (McKinney 1975).

[88]*In re* Bronson, 150 N.Y. 1, 5, 44 N.E. 707, 711, 110 N.Y.S. 949, 954 (1896) (Vann, J., dissenting).

[89]*See, e.g.*, People v. Irrizari, 5 N.Y.2d 142, 156 N.E.2d 69, 182 N.Y.S.2d 361 (1959).

[90]MODEL PENAL CODE § 223.0(6) (Proposed Official Draft, 1962).

theft includes depriving the owner of either the property or some legal interest therein, either permanently or for some extended period of time.[91] If the right to secrecy or the right to payment for use of a program is "property" in the sense the Code intends (and it quite reasonably could be so interpreted), misappropriation of a program could be prosecuted as theft under the Code. The Code also has a section which defines the offense of theft of services which might be stretched to prosecute someone who knowingly or fraudulently obtains computer services of any sort without any intent of paying for them.[92] The value of property stolen is taken to be the "highest value, by any reasonable standard" of that property;[93] thus, the commercial value of a purloined program would certainly be admissible.

4. Federal Law.—The principal federal statute related to theft, section 641 of title 18 of the United States Code, is quite comprehensive concerning the acts covered and the res required.[94] Forbidden activity includes embezzling,[95] stealing, knowingly converting to the use of the actor or a third party, as well as selling, disposing of, or conveying without authority "anything of value" which belongs to the United States or any department or agency thereof, or even any property which has been made or is being made under contract for the United States or any of its departments. The statute also proscribes receiving and hiding stolen property if it is known to have been stolen.

Stealing is a narrower notion than conversion. The Supreme Court has drawn the following distinction:

> To steal means to *take away from one* in lawful possession without right with the *intention to keep* wrongfully . . . .

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[91] *Id.* §§ 223.0(1), (5), .2(1).

[92] *Id.* § 223.7.

[93] *Id.* § 223.1(2)(c).

[94] The statute provides for a fine and imprisonment for:

> [Whomever] embezzles, steals, purloins, or knowingly converts to his use or the use of another, or without authority, sells, conveys or disposes of . . . anything of value of the United States or any department or agency thereof, or any property made or being made under contract for the United States or any department thereof, or whoever receives, conceals, or retains the same with intent to convert it to his use or gain, knowing it to have been embezzled, stolen, purloined or converted . . . .

18 U.S.C. § 641 (1976).

[95] Embezzlement is fraudulent or felonious conversion or appropriation of property which has *rightfully or lawfully* come into the converter's possession. For a fairly comprehensive discussion of embezzlement and § 641, see United States v. Powell, 294 F. Supp. 1353 (E.D. Va. 1968), *aff'd per curiam*, 413 F.2d 1037 (4th Cir. 1969).

> Conversion, however, may be consummated without any intent to keep and without any wrongful taking, where the initial possession by the converter was entirely lawful. Conversion may include misuse or abuse of property.[96]

The Court of Appeals for the Third Circuit interprets the Supreme Court as saying that section 641 applies when anyone obtains a wrongful advantage from the property of another.[97] Section 641 has also been used to successfully prosecute an army officer who used the services of government employees for his own personal gain.[98]

The phrase "of the United States or of any department thereof" is to be interpreted with great latitude as well. For example, if the government has a license for the use of certain programs, theft of the programs would suffice to invoke federal jurisdiction. "In its broadest interpretation, any misappropriation of software which is subject to some measure of government control, custody, or ownership is a violation of section 641."[99] The measure of value of any item misappropriated is the "face, par, or market value, or cost price, either wholesale or retail, whichever is greater."[100] This implies that the commercial value of a stolen program would be accepted by a court as a measure of its worth. If the program were completely lost to its owner, the cost of rewriting it might be acceptable.

Other federal statutes also apply to theft-related offenses. Section 659 of title 18, for example, deals with theft from an interstate common carrier, and applies regardless of who owns the goods stolen: "The interstate character of a shipment commences at the time that the property is segregated for interstate commerce [such character continuing] until the property arrives at its destination and is there delivered either by actual unloading or by being placed to be unloaded."[101] The particular act proscribed by this statute is more limited than that covered by section 641. Although the required intent is the same as that for conversion, the act in question must be theft or embezzlement.[102] The act does not seem to cover unauthorized copying. Section 2314 of title 18 also forbids interstate transportation of stolen property. The stolen article must actually cross state lines to trigger this statute. In *United States v. Lester*,[103]

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[96]Morissette v. United States, 342 U.S. 246, 271-72 (1952) (citing Irving Trust Co. v. Leff, 253 N.Y. 359, 364, 171 N.E. 569, 571 (1930)).

[97]United States v. Crutchley, 502 F.2d 1195, 1201 (3d Cir. 1974).

[98]Burnett v. United States, 222 F.2d 426, 427 (6th Cir. 1955).

[99]Nycum, *supra* note 33, at 306.

[100]18 U.S.C. § 641 (1976).

[101]United States v. Astolas, 487 F.2d 275, 278 (2d Cir. 1973).

[102]This interpretation is strongly implied by the language in United States v. Astolas, *id.* at 279. *See also* Nycum, *supra* note 33, at 307.

[103]282 F.2d 750 (3d Cir. 1960).

a conviction was upheld even though the defendant had merely transported misappropriated copies of commercially valuable geological survey maps across state lines.[104] This decision implies that section 2314 could perhaps be invoked if someone carried an unauthorized copy of a computer program across state lines. Other federal laws, such as that which covers conversion by a government employee of property entrusted to his care,[105] may also be helpful in curbing computer crime in certain carefully defined situations.[106]

C. Other Federal and State Statutes

Although theft of software constitutes one of the largest potential sources of loss due to computer crime, there are other ways to lose than by theft and other ways to misappropriate things than by simply carting them off. A common problem at university computing facilities, for example, is unauthorized use of the machine, that is, misappropriation of computer time and resources. Because these are "things of value," it is likely that, even in this case, many state larceny statutes might be applicable. There are usually other state statutes which could be used to handle this situtation, at least if a court can be convinced to interpret such statutes in a reasonable, though possibly broad, manner. For example, even an unauthorized user must usually provide an account number to which his use of computer resources will be charged. Furnishing this information is, in effect, fraudulently tendering a credit card because the account the user is tendering is not his own.[107] This practice can lead to prosecution under a credit card fraud statute.[108]

Damaging information that is stored on magnetic tape, for example, garbling the information by passing it through a strong magnetic field, is almost certainly prosecutable under a malicious mischief statute, provided that the court can be apprised of the precise nature of the damage done.[109] If anyone breaks and enters a computer facility with the express purpose of doing substantial damage or committing some other felony, he is, of course, subject to prosecution for burglary as well.[110]

Some states have "telephone abuse" statutes which might be used to prosecute someone who attacks a computer or its contents from a

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[104]*Id.* at 754-55.

[105]18 U.S.C. § 654 (1976).

[106]*See* 18 U.S.C. §§ 285, 655-57, 1707, 2113 (1976).

[107]If a false name or identification is used, forgery might also be involved. This raises the question of what constitutes a "signature" in dealing with a computer. The question is not without importance in view of the arrival of electronic funds transfer.

[108]*See, e.g.*, IND. CODE § 35-43-5-4 (Supp. 1979).

[109]*See, e.g., id.* § 35-43-1-2.

[110]Criminal trespass might also apply. *See, e.g., id.* § 35-43-2-2.

remote site via a telephone line. Although the laws of each state are different, there is no state which does not already have a substantial arsenal of statutes dealing with larceny, fraud, and invasion of privacy which can be used against the computer criminal. Other statutes dealing with credit card fraud, fraudulent destruction of recordable instruments,[111] or tampering with records[112] might also prove to be valuable weapons.

Other federal laws besides those related directly to larceny can also be employed against computer crime.[113] The two principal statutes which deal with abuse of federal channels of communication are sections 1341 (mail fraud) and 1343 (wire fraud) of title 18. Both statutes have two essential elements: 1) the actor must use the mail (wire) for the purpose of executing, or attempting to execute, 2) a fraud or scheme to obtain money or property under false pretenses. Fraud has been liberally interpreted by the federal courts, and it is likely that they would find fraud in a scheme to obtain an unauthorized copy of a program. All cases tried to date under the wire fraud statute have involved calls which have crossed state lines.[114]

One such wire fraud case was *United States v. Seidlitz*.[115] Seidlitz, who operated his own computer business in Virginia, had obtained access codes to the computer of a former employer, Optimum Services, Inc. (OSI), located in Rockville, Maryland. OSI had developed a sophisticated program that Seidlitz misappropriated for his own personal gain. He obtained the electronic signals which represented the program through interstate telephone lines. Once the transmission had been made, he could, of course, print copies of the program from the stored information. Seidlitz also had a computer terminal in his home in Maryland. As events turned out, he would have been better off had he stolen the programs using that terminal. Seidlitz's thievery was discovered, as are most such computer crimes, purely by accident.

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[111]MODEL PENAL CODE § 224.3 (1962).

[112]*Id.* § 224.4.

[113]Nycum classifies the federal statutes under seven broad headings: 1) theft and related crimes, 2) abuse of federal channels of communication, 3) national security offenses, 4) trespass and burglary, 5) deceptive practices, 6) malicious mischief and related offenses, and 7) miscellaneous other statutes. Nycum, *supra* note 33, at 305. This general order will be followed here.

[114]Nycum, *supra* note 33, at 311-12.

[115]This is an unreported case discussed in SECURITY, *supra* note 20, at 234. The report and analysis of this case were submitted to the Committee on Governmental Operations by Mr. Jervis Finney, U.S. Attorney for the District of Maryland, the jurisdiction within which the crime occurred.

Mr. Jarvis Finney, in a report to the Senate Committee on Governmental Affairs, pointed out some of the serious problems associated with trying to win a conviction in this kind of case under existing state and federal law.[116] First, there is the problem of proving that Seidlitz actually called the computer from which he was stealing programs. Having established this, "it is also incumbent to establish, with precision, what material is being retrieved from the computer. Unless the victim company has certain specialized equipment available, this may pose an extreme burden which can seriously hamper any attempt to obtain a search warrant."[117]

If it had been determined that Seidlitz had indeed phoned OSI's computer and that OSI knew precisely what information had been transmitted to Seidlitz's phone, a search of his premises may have revealed no identifiable copies. The evidence could have been entirely concealed on magnetic tapes or in invisible electronic switches at the heart of his computer. The program could have been scrambled in such a way that only Seidlitz could decode it by means of another secret program; hence, an exhaustive search of his home and business might have revealed no clear evidence of any crime, even if the entire contents of his computer's memory had been "dumped" and given to a computer specialist to read.[118] Such a blanket seizure and examination of all of Seidlitz's records and all of the information stored in his computer, however, might have run afoul of the fourth amendment.

If Seidlitz had not transmitted the programs to Virginia, the wire fraud statute would have been useless. Moreover, a charge of interstate transportation of stolen property was dismissed due to a lack of asportation. The programs that Seidlitz misappropriated were not really carried off; they still resided inside OSI's computer. Seidlitz had merely reproduced them by means of an electronic signal over the phone. The case was thus distinguishable from those in which a copy had first been made and then transported interstate.

A conviction for what must appear to most sensible people to be a crime was nearly avoided because what was stolen was not carried off. Whether the court would have found asportation if he had erased the program in OSI's computer at the same time he copied it into

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[116]Unfortunately, many prosecutors faced with similar difficulties would not have attempted any prosecution, perhaps suggesting a suit in tort as a remedy for the injured party.

[117]SECURITY, *supra* note 20, at 235.

[118]Inasmuch as computer systems can hold information equivalent to miles of printed copy, the sheer task of searching for the evidence is like looking for the proverbial needle in the haystack.

his own is a matter of conjecture. It would certainly seem that the gratuitous destruction of OSI's program should not be required to classify Seidlitz's act as a theft. The courts would do well to reexamine the concept of asportation in situations such as this.

There are rather specialized statutes which relate to national security.[119] The broadest of these, section 793(f) of title 18, seems to proscribe virtually any malfeasance having to do with information or documents related to national security, including the knowing failure to report the loss of such a document.[120]

Federal statutes concerning trespass and burglary refer to specialized areas, such as banks and post offices, and not to the more general notion of "federal enclave."[121] It appears that section 2113(a) of title 18, which deals with robbery of a bank, refers only to common law larceny[122] and not to a more extensive notion that might enable a court to find larceny in misappropriation of a trade secret. The Supreme Court, moreover, has held that federal criminal law in this respect is not to be interpreted in the light of state law.[123] Thus, these statutes are not as helpful in prosecuting computer crime as they may first appear. The Assimilative Crimes Act, however, adopts state penal law to fill in the gaps in federal law for each federal enclave in the state.[124] Thus, even though federal law may be deficient when considered in isolation, state law may remedy that deficiency.

Several federal statutes relate to deceptive practices,[125] but by far the most comprehensive of these is section 1001 of title 18.[126] All that section 1001 requires is some "false, fictitious or fraudulent statement, knowingly and willfully made." The statute applies to both oral and written representations.[127] Because an entry of a

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[119]18 U.S.C. §§ 793-95, 797-99, 952 (1976).

[120]*Id.* § 793(f).

[121]*See Id.* § 7 for the definition of federal property for purposes of the criminal code.

[122]The statute was so construed in United States v. Rogers, 289 F.2d 433, 437 (4th Cir. 1961).

[123]Jerome v. United States, 318 U.S. 101, 106 (1943).

[124]*See* note 36 *supra* and accompanying text.

[125]18 U.S.C. §§ 912, 1001, 1005, 1006 (1976).

[126]Section 1001 provides in part:

> Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme or device a material fact, or makes any false, fictitious, or fraudulent statements or representations or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined . . . .

18 U.S.C. § 1001 (1976).

[127]United States v. Zavala, 139 F.2d 830, 831 (2d Cir. 1944).

password or authorization code into a computer is a statement that the one who enters it is entitled to what he orders the computer to give him, this statute would seem to be a likely weapon with regard to misappropriation of computer services or information stored in a computer in any case in which the actor misrepresents his identity or his status.

An instructive case relating to computer abuse by fraud is *United States v. Jones.*[128] Through a sophisticated scheme, again discovered solely by chance, the defendant's brother had a computer generate checks payable to the defendant which should have been payable to the defendant's employer. Because the payor on these checks was Canadian, the defendant was charged with transporting foreign commerce checks valued at more than $5,000, knowing the checks had been taken by fraud,[129] and of unlawfully converting these checks knowing them to be fraudulent.[130] The defendant moved that the indictments be dismissed on the grounds that the checks in question were actually forgeries and, therefore, did not fall under the provisions of the statutes under which she was charged.[131] The district court held that the checks were indeed forgeries and dismissed the indictments;[132] the government appealed.

The legal issue on appeal was whether "the alteration of accounts payable documents fed into a computer which resulted in the issuance of checks payable to an improper payee constituted a 'falsely made, forged, altered, counterfeited or spurious' security."[133] The Court of Appeals for the Fourth Circuit reversed the district court, holding that the acts which caused the computer to print the fraudulent "checks did not constitute the making of a false writing, but rather amounted to the creation of a writing which was genuine in execution but false as to the statements of fact contained in such writing."[134]

The prosecuting attorney pointed out that if the checks had been found to be forgeries, and the indictments had been dismissed, then there would probably have been no federal statutes under which the defendant could have been charged.[135] The mail fraud

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[128]553 F.2d 351 (4th Cir. 1977), *cert. denied*, 431 U.S. 968 (1977). This case is discussed in SECURITY, *supra* note 20, at 236-37.

[129]18 U.S.C. § 2314 (1976).

[130]*Id.* § 2315.

[131]The statutes did "not apply to any falsely made, forged, altered, counterfeited or spurious representation of an obligation or . . . promise to pay . . . by a bank or corporation of any foreign country." 553 F.2d at 352 n.2.

[132]United States v. Jones, 414 F. Supp. 964, 971 (D. Md. 1976).

[133]553 F.2d at 354.

[134]*Id.* at 355.

[135]SECURITY, *supra* note 20, at 238. *See* note 103 *supra.*

statute might have been the only other possibility, but it would have required some proof that checks were placed in the mail in a scheme to defraud, whereas no checks might have been sent through the mail. "Thus, there may be instances where computer-related criminal activity has no criminal sanction."[136]

Federal statutes which deal with the destruction of property seem well-styled to handle a broad spectrum of possible offenses;[137] section 1361, which deals with the malicious destruction of government property, is the widest in its scope. It has been used in a case in which blood was poured on selective service records.[138] In that case, the value of the property injured was taken to be the cost of restoring the damaged records.[139]

Despite the seeming availability of statutory protection, prosecution of computer "criminals" is often difficult. This point is illustrated by testimony given by Ms. Susan Nycum before a Senate subcommittee in which she related a personal experience concerning computer abuse which might not have been prosecutable.[140] While Ms. Nycum was in charge of a computer center, one of her staff detected a user attempting to erase the volume table of contents for the system. The destruction of this master file would have created havoc in the computer operations. According to Ms. Nycum's estimate, it would have cost $50,000 to recreate the file. The attempt at destruction was made from a terminal outside the computer center itself using intrastate telephone lines and was frustrated only because of prompt action taken to disconnect the caller. Despite the large amount of damage and incovenience that would have resulted had the attempt succeeded, local law enforcement agencies were not sure that there was any law under which they could prosecute. The best they could do was suggest that the perpetrator be charged with making an obscene phone call. No charges were filed. Though state authorities were involved in the incident, it is not clear that under the circumstances federal authorities would have had an option of prosecuting even for an obscene phone call.

Some miscellaneous federal crimes with which a computer criminal could be charged include aiding and abetting a criminal,[141] assisting the actor after the commission of the crime as an accessory after the fact,[142] and conspiracy.[143] A government employee can be

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[136]SECURITY, *supra* note 20, at 238.

[137]18 U.S.C. §§ 81, 1361, 1363, 2071, 2153, 2155 (1976).

[138]United States v. Eberhardt, 417 F.2d 1009 (4th Cir. 1969).

[139]*Id.* at 1013.

[140]*Hearings*, *supra* note 6, at 70.

[141]18 U.S.C. § 2 (1976).

[142]*Id.* § 3.

[143]*Id.* § 371.

charged with disclosure of confidential information if he discloses secret software in government custody, even if the software is owned by a private party and not the government.[144] In addition, the notion of fraud upon the government is very broad and does not imply pecuniary loss to the government.[145] It is somewhat odd that there is no general federal statute which states that it is a crime to defraud the government; thus, as Ms. Nycum points out, the conspiracy statute makes criminal an act of planning to do something which is itself not criminal.[146]

III. New Legislation

There are already a respectable number of state and federal laws which can be used to combat computer crime. The unique nature of computers, however, poses certain problems in the application of these laws in certain instances. At least two states have passed special legislation to deal with computer abuses, and Congress, along with several states, is considering such legislation. Consideration of this legislation forms the concluding part of this Article.

A. Federal Computer Systems Protection Act

Florida and Arizona have each passed laws specifically directed against computer crime; similar legislation is under consideration elsewhere,[147] and a "Federal Computer Systems Protection Act of 1979" is before the United States Senate.[148] The Senate bill describes the proscribed acts as follows:

> (a) Whoever knowingly and willfully, directly or indirectly accesses, causes to be accessed or attempts to access any computer, computer system, computer network, or any part thereof which, in whole or in part, operates in interstate

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[144]Haas v. Henkel, 216 U.S. 462 (1910).

[145]Nycum, *supra* note 33, at 320.

[146]18 U.S.C. § 1905 (1976).

[147]*See, e.g., California DP Crime Bill Delayed for Redraft*, Computerworld, Mar. 12, 1979, at 14; Whitemarsh, *Colo. Crime Bill Expected to Pass*, and *DP Crime Legislation: A State-by-State Scorecard*, Computerworld, May 21, 1979, at 1. For examples of recent computer crime legislation, *see* Ala. Code § 13A-8-10(b) (1979); Cal. Penal Code § 502 (West 1979); 1979 Ill. Legis. Serv. P.A. 81-548 (West); 1979 N.C. Adv. Legis. Serv. No. 7, C. 831; Utah Code Ann. § 76-6-701 to -704 (Supp. 1979).

[148]S. 240, 96th Cong., 1st Sess., 125 Cong. Rec. S709 (daily ed. Jan. 25, 1979). This was originally Senate Bill S. 1766, the "Federal Computer Systems Protection Act of 1977." Although most witnesses at the hearings on this bill felt that new legislation was needed, almost no one was satisfied with the bill itself. Senator Ribicoff redrafted the bill, incorporating certain suggestions of then Assistant Attorney General Benjamin Civiletti. Cong. Rec. at S719-24. *See Hearings, supra* note 6.

> commerce or is owned by, under contract to, or in conjunction with, any financial institution, the United States Government or any branch, department or agency thereof, or any entity operating in or affecting interstate commerce, for the purpose of:
> (1) devising or executing any scheme or artifice to defraud, or
> (2) obtaining money, property, or services, for themselves or another, by means of false or fraudulent pretenses, representations or promises, shall be fined a sum not more than two and one-half times the amount of the fraud or theft or imprisoned not more than 15 years or both.
> (b) Whoever intentionally and without authorization, directly or indirectly accesses, alters, damages, destroys, or attempts to damage or destroy any computer, computer system, or computer network described in subsection (a), or any computer software, program or data contained in such computer, computer system or computer network, shall be fined not more than $50,000 or imprisoned not more than 15 years or both.[149]

The bill continues with an extensive and fairly complex list of definitions. "Access" is defined so broadly that it could include the use of almost anything having something to do with a computer.[150] On the other hand, the definition of "computer" is both too narrow and too broad. It is limited to electronic devices which manipulate data via electronic or magnetic impulses, thus excluding some of the major new forms of computers,[151] yet the definition is not restricted to general purpose machines, thus opening the way for rulings that electronic watches and automated traffic signals are covered by the bill.[152] Moreover, because the notion of computer is extended to "all input, output, processing, storage, software, or communication facilities which are connected or related to such a device in a system

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[149]125 CONG. REC. at S709.

[150]"'Access' means to approach, instruct, communicate with, store data in, retrieve data from, or otherwise make use of any resources of, a computer, computer system, or computer network." *Id.* at S710.

[151]*Hearings*, *supra* note 6, at 67 (testimony of D. Parker).

[152]*See id.* Apparently the Senate Criminal Justice Subcommittee found the definition too broad as well. In the version voted out of that committee on November 6, 1979, automated typewriters, home computers and hand-held calculators were specifically exempted. In place of the many paragraphs of definitions dealing with computers, computer systems, computer networks, and so forth, the committee defined a computer as "a device that performs logical, arithmetic and storage functions by electronic manipulation and includes any property and communication facility directly related to or operating in conjunction with such a device." *DP Crime Bill Progresses in Senate*, COMPUTERWORLD, Nov. 19, 1979, at 2, col. 2 [hereinafter cited as *DP Crime Bill*].

or network,"[153] it appears that software and even telephones are to be treated as part of the computer itself. Yet, despite this seeming breadth, it appears that one of the most serious potential sources of loss, illicit photocopying of a printed program, is not covered at all.

The Senate bill is inadequate for two reasons. First, the proposed legislation duplicates much existing legislation. Second, and almost antithetical to the first conclusion, this bill ranges so broadly and is written so unclearly that it is hard to say with any degree of certainty exactly what the bill proscribes. Because its penalties are rather severe—up to fifteen years in prison for perhaps twenty-five cents worth of misappropriated computer time—the legislation should be more specific concerning what actions it covers.

The scope of federal jurisdiction is one of the most striking features of the bill. It seems even broader than section 641 of title 18, which is quite broad indeed.[154] For example, a state university computer which is used, even in small part, to process data in conjunction with some federally funded research project, would apparently be protected by the bill. Thus, a student having no connection with any federal program might be subject to federal prosecution and fifteen years in jail for causing such a computer to print out some obscene comment on a terminal. There is scarcely any computer operation of any size which is not likely to fall under the protection of the bill. Carried to its extreme, this bill will cover a theft of an electronic wristwatch in interstate commerce, and might even cover running a red traffic light.[155]

Another serious problem is the bill's ambiguity regarding what actions constitute a crime. It is common practice within computer operations to attempt to devise ways to beat the system, cause it to "crash," or obtain data to which they are not entitled. Some computer operations tolerate such antics, even though the consequences can be annoying, because it helps them locate and correct security flaws. It is virtually standard practice as well, particularly with university systems, for students to play unauthorized games such as

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[153]125 CONG. REC. at S710.

[154]*See* notes 94-100 *supra* and accompanying text. The Senate Criminal Justice Subcommittee's version submitted to the full Senate Committee on the Judiciary now "covers all computers used by the federal government, by financial institutions or in interstate commerce." *DP Crime Bill*, *supra* note 134, at 2, col. 2. This version is still very broad.

[155]An automated traffic light, particularly one which is attached to a computer which counts cars and times the cycle of red and green, is part of a computer system as defined by this bill. If the traffic light controls traffic on a heavily traveled interstate route, it is arguably operating in interstate commerce. Absurd as it may seem, a driver who runs a red light could be charged with unauthorized access to, or alteration of, the system. The Senate Subcommittee which considered S.240 did try to make some changes that addressed some of these problems. *See* note 152 *supra*.

"Star Trek," print "Snoopy" calendars or pictures of the Mona Lisa, compile statistics for bowling leagues, or do other jobs that the rules of the system definitely forbid. These rules, however, are virtually unenforceable, and abuses are sometimes winked at to encourage students to gain greater experience in the use of the computer. Punishment of a $50,000 fine and fifteen years in jail for such pranks clearly seems excessive.[156] It is also doubtful that the bill could survive a constitutional challenge on the grounds of vagueness.

B. The Arizona Statute

The definition of the relevant computer-related terminology in the Arizona statute[157] is quite similar to that of Senate bill 240 and thus suffers from the same defects. The main body of the legislation creates a new crime, computer fraud:

> A. A person commits computer fraud . . . by accessing, altering, damaging or destroying without authorization any computer, computer system, computer network, . . . with the intent to devise or execute any scheme or artifice to defraud or deceive, or control property or services by means of false or fraudulent pretenses, representations or promises.
> B. A person commits computer fraud . . . by intentionally and without authorization accessing, altering, damaging or destroying any computer, computer system or computer network or any computer software, program or data contained in such computer, computer system or computer network.[158]

Although the scope of this statute is not quite as broad as the Senate bill, it suffers from many of the same ailments. It is not clear what acts are specifically forbidden, and the Arizona Attorney General has admitted that student use of computer time without authorization would be a violation. He would rely on prosecutorial discretion to avoid abuse of the law.[159] As was the case with Senate bill 240, the law does not seem to make unauthorized copying of a program a crime under many common circumstances.

The Arizona law suffers from yet another defect. Some of the terms in the new law are defined in pre-existing statutes. The com-

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[156]The latest version of the bill (amended in subcommittee) reduced the penalties to a fine "of two times the amount lost or $50,000, whichever is higher and/or five years in jail," to bring them into line with the federal wire and mail fraud statutes. *DP Crime Bill*, *supra* note 152, at 2, col. 2.

[157]ARIZ. REV. STAT. ANN. § 13-2316 (1978).

[158]*Id.*

[159]*Hearings*, *supra* note 6, at 143.

puter fraud statute speaks of the "intent to . . . control property."[160] In section 13-1801, which deals with definitions related to theft, "control" is defined as an act by a defendant which excludes an owner from using his property except on the defendant's own terms.[161] In stealing a copy of a program for personal use, an actor would not control the program in this sense. Arizona courts will have to determine whether the new law has actually extended the notion of control.

C. The Florida Statute

Florida has chosen to use definitions similar to those proposed by the Association for Computing Machinery (ACM), the largest organization of computer professionals in the world.[162] "Computer" is defined in the Florida Crimes Act[163] as "an internally programmed, automatic device that performs data processing."[164] Similar to the ACM definition, the definition is, unfortunately, not the same. It obviates the "electronic" limitation of Senate bill 240, but it lacks the important provision of "general purpose." Thus, it appears that Florida law could also find computer crime in unlikely places such as wristwatches. The Florida law defines three categories of offenses: offenses against intellectual property, offenses against computer equipment and supplies, and offenses against computer users.[165]

Offenses against intellectual property include knowing and unauthorized modification, alteration, or destruction of programs, data, or supporting documentation, as well as the taking of computer-related documents which are trade secrets.[166] Presumably, this latter category would include the unauthorized taking of a copy of a secret program. Offenses against computer equipment include taking, injuring, or damaging the tangible objects associated with a computer system.[167] The heart of the section on offenses against computer users is the following paragraph:

> Whoever willfully, knowingly, and without authorization accesses or causes to be accessed any computer, computer system, or computer network; or whoever willfully, knowingly, and without authorization denies or causes the denial of computer system services, . . . which, in whole or part, is owned

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[160]ARIZ. REV. STAT. ANN. § 13-2316 (1978).
[161]*Id.* § 13-1801.
[162]*Hearings, supra* note 6, at 136.
[163]FLA. STAT. §§ 815.01-.07 (Supp. 1979).
[164]*Id.* § 815.03(3).
[165]*Id.* §§ 815.04-.06.
[166]*Id.* § 815.04.
[167]*Id.* § 815.05.

> by, under contract to, or operated for, on behalf of, or in conjunction with another commits an offense against computer users.[168]

In its attempt to define and address computer abuse and to address special computer-related questions which are not likely to be answered by existing law, the Florida statute is unquestionably the best of the three laws considered. Knowing and willful alteration of the program of another so that it will not run is a crime under Florida law. One need not argue the value of the damage done, the cost of correcting the damage, or whether the owner was deprived of control. The alteration can be prosecuted as an offense against intellectual property.

An ideal computer abuse bill should be general and flexible enough to lend itself to rapidly exploding computer technology and new uses to which computers might be put, yet narrow enough to exclude watches, traffic signals and pocket calculators. It should address those special questions that computers raise without unnecessarily infringing on areas already covered by existing legislation. Finally, it should specify exactly which acts constitute crimes under the law and which do not.

At least two approaches are possible. The first is to draft statutes which expand common law notions of property and asportation, at least in the case of computer-related items, to enable acts of computer abuse to be treated under existing penal statutes. The second alternative is to draft laws specifically creating new offenses related to computer abuse. The advantage of the first approach, of course, is that it takes advantage of existing law, law with which courts and attorneys have already had experience. The following is a suggested example of this type of statute: For purposes of application of any statute in which the taking of, or damage to, property is an essential element, property shall include computer programs, whether internal or external to, a computer. A computer program will have been asported or taken if an unauthorized copy is made, it being sufficient that the copy, if not reduced to tangible form, is embodied internal to a computer system, even though the owner of the program thus copied remains in possession and control of his original. If the value of such program asported is to be established, it shall be the commercial value of the program as established by expert witness.

As an example of model legislation embodying the second approach, this writer recommends the Florida statute slightly modified by using the ACM definitions throughout.[169]

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[168] *Id* § 815.06.

[169] The ACM definitions are given in *Hearings*, *supra* note 6, at 54. The relevant portions of the Florida legislation are reprinted. *Id.* at 136-38.

IV. INDIANA LAW

A. The Case of John Thommen

A recent Indiana case[170] dealt with virtually all of the legal issues raised by computer abuse. The defendant, John Thommen, was convicted of theft, which the Indiana Code defines as "unauthorized control over property of another person, with intent to deprive the other person of any part of its value or use."[171]

John Thommen was a statistician in the Indiana Department of Mental Health. Because of the nature of his work, he was given one of a limited number of TSO (time-sharing option) terminals in use on the Indiana Central Data Processing Network. TSO terminals permit the user to modify programs he is running as well as receive data. Central Data Processing (CDP) ran two IBM 370/168 computers in tandem and served more than fifty state agencies, including the Bureau of Motor Vehicles, various licensing and registration boards, and the Department of Public Welfare.

Because so many different agencies used the same network, there was an operating systems program which was designed to prevent any user from obtaining access to any file or program to which his job did not entitle him. Because Thommen had a TSO terminal and was able to obtain the name of this systems program and the special program which enabled him to print a copy, he was able to modify the program to permit him to access any program or file of any kind anywhere on the system. Thommen kept an altered version of the security program in his own files. When he wanted to access files which the original security program would not have permitted him to have, he replaced that security program with his own, obtained the files or information he wanted, and then reinserted the correct security program into the system. Anyone checking the security program, except during those times when he had his own version in operation, would have found nothing amiss.

Thommen's duties for the Department of Mental Health included generating reports and creating statistical data. He had no programming responsibilities, and he certainly did not have authorization from his superiors to embark on a full-scale exploration of CDP. As

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[170]State v. Thommen, No. 79-424B (Crim. Ct. Marion Co. Feb. 14, 1980).

[171]IND. CODE § 35-43-4-2(a) (Supp. 1979). Most of the information concerning the case of John Thommen was gained in a two hour interview on March 6, 1980, with Sgt. James Smith of the State Police Data Processing Section, who was the principal investigator on the Thommen case. Sgt. Smith also allowed the author to read in his office certain reports written as a result of his investigation. State Police regulations prevented the author from removing this material from Sgt. Smith's office or making copies. *See Statistician Convicted in Computer Case*, The Indianapolis Star, Feb. 14, 1980, at 26, col. 1.

a computer user in the Indiana CDP network, he had been assigned an identification code (ID) which identified him and his department, and which also permitted the system to keep track, to a limited extent, of how much he used the computer and what programs he used. The ID also served as the key in the security program to determine what files or programs he could legitimately access. Whenever Thommen's ID was used to "log on" to the system, CDP automatically made a record of it. There was, however, no means of confirming that it was Thommen personnally who was using that ID, or that Thommen at times was not actually doing computer work under someone else's ID. There was not even a way to determine which terminal was being used under Thommen's ID or where it was located. This, of course, presented a serious identification problem in trying to tie Thommen to any illegal computer uses. Anyone familiar with Thommen's ID and certain other easily accessible information could have been using the system as well as he.

Again, the fact that something was amiss was discovered completely by chance. Each user in the CDP network is assigned a support team, essentially a group of consultants. One member of a support team visiting the Department of Mental Health was helping Thommen with a problem with one of his statistical programs when the support team member happened to notice a "print-out" lying in plain view on Thommen's desk; the print-out, the consultant realized, was of a highly confidential security program to which even the consultant did not have access.

The consultant reported his discovery to his superior, who was equally surprised to find that Thommen had a copy of such a restricted program. They were not yet aware of the extent to which Thommen had actually compromised what security there was in their network or how much unauthorized use Thommen had made of files to which he supposedly had no access.

The State Police were called in to investigate the irregularities, although Thommen did not, at that time, realize that his activities were attracting attention. The investigation was conducted primarily by Sgt. James Smith of the Data Processing Division of the Indiana State Police. Compiling evidence took literally hundreds of hours of Sgt. Smith's time because he had to familiarize himself with the CDP system as well as print and sift through volumes of computer print-outs concerning terminal and computer usage involving Thommen's ID and other IDs used in the Department of Mental Health. The investigation was also complicated by the fact that CDP had no adequate method of keeping track of computer usage. Smith had to meticulously cull through piles of records to find what accesses had been made on Thommen's ID and what particular systems programs

or files were called during that access. If the program or file called had no relationship to Thommen's work, it was considered an unauthorized access. More than 3,700 such unauthorized accesses were found. Sgt. Smith estimated that Thommen was spending at least twenty percent of his working time dealing with material which was not related to his job functions with the Department of Mental Health. Sgt. Smith's investigation continued from May 27, 1978, until May 4, 1979, when CDP, alarmed at the potential consequences of Thommen's manipulations of their system, invalidated his access code. Denial of access to the computer alerted Thommen that he was under investigation. He was then able to destroy whatever "hard copy" evidence there may have been to link him with the abuses with which he was later formally charged. Any chance of determining exactly what modifications Thommen had made in the computer system, or what, if any, personal gain he had received from his efforts were lost.

The prosecutor seeking an indictment and later a conviction against Thommen was faced with important problems of evidence and procedure. In the first place, it was impossible to determine whether Thommen had used the computer to take money. Thommen had accessed a highly sensitive program in the Department of Public Welfare which was designed to make payments automatically to qualified individuals and services. He also had the capability to make the computer issue checks to fictitious accounts, an action almost impossible to detect with the audit procedures then in use.[172] The prosecutor tried to frame an indictment so that if theft of funds was discovered later, prosecution would not be barred by double jeopardy. This problem was solved by charging Thommen with theft of computer time, specifically, nine separate instances of unauthorized access to programs.[173]

There was the additional problem of tying Thommen to the unauthorized uses. All that was known initially was that someone somewhere, using Thommen's ID, was using the computer. There was no direct evidence that the person using Thommen's ID was

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[172]*Cf. Fraud Scheme at SSA Office Nets $500,000*, COMPUTERWORLD, Mar. 3, 1980, at 1, col. 1 (computer fraud involving Social Security disability claims).

[173]One of these counts was based on playing computer games; the remainder were based on more substantial activities. Sgt. Smith reported receiving several phone calls from local industry complaining that the Thommen conviction might unduly frighten computer operators who had indulged in such relatively innocuous activities as game playing on the company computer. Sgt. Smith indicated that no prosecutions for such activity were planned and that the Thommen case was unusual because of the scope of the abuse involved. Interview with Sgt. James Smith, Indiana State Police Data Processing Section, in Indianapolis (Mar. 6, 1980) [hereinafter cited as Interview].

Thommen. Thommen solved this problem for the prosecution by admitting that he was the unauthorized user of the computer during the times in issue. He claimed, however, that he was merely sharpening his skills and that he had never been given any instructions as to what he could or could not do with the computer. If Thommen had not admitted he was the one who made improper use of the computer, it may have been impossible to convict him.

One of the most serious evidentiary problems was the highly technical nature of the evidence.[174] Persons who are not knowledgeable in computer use may find it hard to understand why, if Thommen could "call" certain files stored in the computer, he could not look at certain other files.[175] The swapping in and out of the computer's operating system of the program which allowed Thommen to read files to which he should not have had access was used to prove intent. Also relevant was Thommen's effort to hide what he was doing until he was finally confronted by the police.

The Indiana Criminal Code states: "A person who knowingly or intentionally exerts unauthorized control over property of another person, with intent to deprive the other person of any part of its value or use commits theft, a Class D felony."[176] Because Thommen did not have permission to access the files he dealt with or to engage in programming apart from his statistical analyses in conjunction with his job, his actions constituted unauthorized control over property of the State of Indiana.[177] A more difficult question was the value of what was taken. Because only nine of some 3,000 unauthorized accesses were in issue, most of the exhaustive analysis that Sgt. Smith had done to try to put a value on the total work time and computer usage devoted to non-work-related activities was held inadmissible. The prosecution did manage to convince the jury that something of value was taken.[178]

In his defense, Thommen argued that there were no explicit

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[174]Even the judge commented that the testimony was so technical that he "had trouble following it." The Indianapolis Star, *supra* note 171, at 26.

[175]Could a public library restrict a patron to books on specific shelves? Could it prosecute him for looking at books on the forbidden shelves?

[176]IND. CODE § 35-43-4-2(a) (Supp. 1979).

[177]State v. Thommen, No. 79-424B (Crim. Ct. Marion Co. Feb. 14, 1980). Sgt. Smith indicated that neither the prosecution nor the defense seemed to have been aware of that section of the Indiana Code that defines "unauthorized." Interview, *supra* note 173. Unauthorized control is defined as control exerted, *inter alia*, "(1) without the other person's consent; (2) in a manner or to an extent other than that to which the other person has consented." IND. CODE § 35-43-4-1(b) (Supp. 1979).

[178]State v. Thommen, No. 79-424B (Crim. Ct. Marion Co. Feb. 14, 1980). Note that the statute in question does not require proof of a specific value, only that the object has some value. IND. CODE § 35-43-4-2 (Supp. 1979).

rules prohibiting his access to the files in question; that he did not deprive the State of anything;[179] and that what he did was job related because it sharpened his skills as a computer operator. Nevertheless, the jury found Thommen guilty on all nine counts.[180]

The implications of this case for Indiana's CDP, and other computer systems, are staggering. Apart from Thommen's legal guilt or innocence, this case demonstrated that the security of CDP, which serves virtually all State agencies and offices, was so weak that someone at one terminal in one department could compromise the entire system, read and alter programs and files throughout the system at will, and even cause large sums to be paid to himself in a manner that was all but undetectable. It showed that CDP had no adequate means to determine who was using its system, that there was no adequate billing procedure to determine the value of any work done on the system, and that there were no clear rules governing the conduct of those whose jobs gave them access to the system. There were no alarms that alerted authorities when a user accessed a particularly sensitive program, and no way to check whether any of the systems programs or files stored in the system had been altered. Sgt. Smith voiced a fear that Thommen may have put a "time bomb" into the system which will "explode" in months by sending him a check for $1 million.[181] At the present time, there is no way to detect the existence of that time bomb.[182]

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[179]The CDP computer was, after all, running all of the time anyway. It could be argued that Thommen's use of the machine really took nothing away and caused the state no added expenses.

[180]State v. Thommen, No. 79-424B (Crim. Ct. Marion Co. Feb. 14, 1980).

[181]Interview, *supra* note 173.

[182]Needless to say, the State CDP has installed far stricter security checks in the system and taken other strong measures to prevent a repetition of the Thommen affair. The following recommendations came out of the Thommen trial and some have already been implemented:

1) There must be better communication between the users of the system and manufacturers of software for the system, that is, CDP. A more formal and reliable procedure must be established between CDP and the user for passing on vital information.

2) All terminal operators must be given a formal interview in which they are given a detailed description of their job and the scope of access they are to have within the system. They should be required to sign an agreement indicating that they have been given this knowledge and that they realize the penalties for refusing to abide by it.

3) There must be a better billing system for the network so that accurate records can be kept of how much use each department and user is making of the network, and for what purposes the computer is being used.

4) All areas of sensitive information must be protected from shared access.

5) CDP must closely monitor systems usage and notify appropriate authorities promptly when something happens that is suspect.

The *Thommen* case is undoubtedly one of the more complex and interesting instances of computer abuse in recent years. It is frightening to consider what Thommen could have done in the way of personal gain or damage to records which are vital to the government of Indiana. It is not known, however, how much he really did. He may even have performed a substantial service by alerting the State to the ease with which the CDP network on which it had become so dependent could be compromised. A future Thommen will find the work much more difficult; it is doubtful that he will find it impossible.

There are interesting questions which could have arisen in the Thommen case but did not; they could easily arise in a later case. First, if Thommen had not confessed, it may have been impossible to tie him to the unauthorized use of computer time. All that was known was that someone using Thommen's ID had done certain things. It was also known that Thommen had occasionally used someone else's ID; such a practice is not unknown in computer usage and there are sometimes good reasons for it. The computer had no means of tracing a use under Thommen's ID to Thommen's terminal.

Second, if Thommen had stored evidence in a small home computer linked to CDP computing by a telephone line, another problem would have been created. The evidence that could have been gleaned from use records available directly from CDP would have been entirely circumstantial and could not have linked Thommen directly to the abuses. Could CDP have "searched" Thommen's home computer without a search warrant sometime when Thommen was linked to the CDP machine; that is, could the State have used the same vehicle to read Thommen's computer files stored in his own computer at home that Thommen was using to read State files, or would a search warrant have been required?[183] The answers to these questions are not clear, but they are certain to arise in some future case.

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6) All CDP users, such as the Department of Mental Health, must know and periodically review the rules of the computer network. When Thommen was compromising the network, many users did not have any idea what was or was not permitted, even according to law.

7) All CDP users must assume strict responsibility for monitoring the computer use of those who work for them. One reason that Thommen was able to do so much questionable work was that no one was checking on him to see what he was doing. It was purely by accident, and because Thommen was careless, that his unauthorized altering of the systems security program was detected. Interview, *supra* note 173.

There remains as well the question of what effect federal wire tap legislation, 18 U.S.C. §§ 2510-2520 (1970), might have on these issues. This question is beyond the scope of this Article.

[183]Associate Professor Henry Karlson of Indiana University School of Law—Indianapolis proposes as an alternative that an authorized copy be considered owned by the owner of the original from which the copy was made.

B. Recommendations

If Thommen's conviction is upheld on appeal under theories which are genuine tests of Indiana's criminal code, if CDP is careful to plug the huge gaps in security through which John Thommen wandered almost at will, if other computer users are also security conscious, and if new technology presents no problems beyond those covered in the current criminal code, then Indiana may not require special legislation dealing with computer crime. If, however, new legislation is called for, the author has made suggestions in the appendices to this Article.

The proposed statutory revisions in Appendix A build upon the current Indiana Code by adding certain computer-related concepts to the definition of property that may be subject to coversion. Appendix B, on the other hand, contains a new section that deals specifically with computer crime. John Thommen was convicted because the jury was convinced that he took "something of value," but the actual value was never shown. Someone who "practices" computer skills by printing a Snoopy calendar also takes something of value in the same sense that Thommen did. Under current law, both are equally subject to prosecution. Appendix B takes into account the special nature of computer abuses and classifies them appropriately.

Computer crime is the crime of the future that is rapidly becoming the crime of the present. Its limits are bounded only by the size and speed of the machines and the skill and imagination of those who use them to subvert the law. The *Thommen* case indicates the scope of the problem. The alternative to ignoring the problem is to leave both government and industry, as well as the general public, open to theft on a scale that dwarfs all previous forms of white collar crime and to losses that must become an intolerable burden for society to bear.

Appendix A

Proposed amendments to existing sections of the Indiana Criminal Code, IND. CODE tit. 35, (1976 & Supp. 1979), which might clarify certain issues involving computer crime include the items listed below. The additions are italicized.

In § 35-41-1-2: "Property" means anything of value; and includes, *but is not limited to*, a gain or advantage *or service* or anything that might reasonably be regarded as such by the beneficiary . . . .

Add to § 35-41-1-2: *The "value" of any property shall be its commercial value, reasonable retail value or cost of production, whichever is greatest.*

In § 35-43-4-1(a): As used in this chapter, "exert control over property" means to obtain, take, *copy, alter,* carry, drive . . . or extend a right to property. *If property is copied or altered, control is exerted through the act of copying or altering, and it is not required that the actor in such an instance exclude the property in question from the possession, control, or use of its owner. A copy or alteration need not be tangible if such copy or altered property may be reduced to tangible form.*

Add to the definition of "credit card" in § 35-43-5-1: *This definition shall be construed to include account numbers, project numbers, passwords or similar signs, symbols or devices by which the holder gains access to goods or services or other property, including, but not limited to, the use of computer services, computer programs, files or data, in any medium.*

With the above proposed clarifications and additions, the following sections may be used to combat computer crime:

35-43-1-2 (criminal mischief)
35-43-4-2 (theft)
35-43-4-3 (criminal conversion)
35-43-5-4 (fraud)

Other sections such as 35-43-2-2 (criminal trespass) and 35-44-3-4 (tampering) may also be applicable in certain situations.

Appendix B

The following is offered as a possible additional section to the Indiana Criminal Code to deal specificaliy with various forms of computer abuse. It is modeled after the Florida statute.

As used in this section, unless the context clearly indicates otherwise:

"Intellectual property" means data including programs.

"Computer program" means an ordered set of data representing coded instruction or statements that when executed by a computer cause the computer to process data.

"Computer" means an internally-programmed, general purpose, automatic device that performs data processing.

"Computer software" means a set of computer programs, procedures, and associated documentation concerned with the operation of a computer system.

"Computer system" means a set of related, connected or unconnected, computer equipment, devices, or computer software.

"Computer network" means a set of related, remotely connected devices and communications facilities including more than one computer system with capability to transmit data among them through communications channels.

"Computer system services" means providing a computer system or computer network to perform useful work.

"Property" means anything of value as defined in section 35-41-1-1, and includes, but is not limited to, financial instruments, information, including electronically reproduced data and computer software and programs in either machine or human readable form, or any other tangible or intangible item of value.

"Financial instrument" means any check, draft, money order, certificate of deposit, letter of credit, bill of exchange, credit card, or marketable security.

"Access" means to approach, instruct, communicate with, store data in, retrieve data from, or otherwise make use of any resource of a computer, computer system, or computer network.

The "value" of property is its commercial value, reasonable retail value, or cost of production, whichever is greatest. The assessment of "value of damage" to property is determined by the cost of restoring the property to its condition immediately prior to being damaged.

Offenses against intellectual property—

1) Whoever willfully, knowingly and without authorization modifies data, programs, or supporting documentation residing or existing internal or external to a computer, computer system, or computer network commits an offense against intellectual property.

2) Whoever willfully, knowingly and without authorization destroys data, programs, or supporting documentation residing or existing internal or external to a computer, computer system, or computer network commits an offense against intellectual property.

3) Whoever willfully, knowingly and without authorization discloses or takes data, programs, or supporting documentation which is a trade secret, or is confidential as provided by law, residing or existing internal or external to a computer, computer system, or computer network commits an offense against intellectual property.

4) An offense against intellectual property is a Class B misdemeanor. However, the offense is a Class A misdemeanor if the value of the property acted upon is at least two hundred fifty dollars ($250) but less than two thousand five hundred dollars ($2500), and a Class D felony if (i) the value of the property acted upon is at least two thousand five hundred dollars ($2500), (ii) the damage causes a substantial interruption or impairment of utility service rendered to the public, (iii) the owner of the property is a bank or financial institution, or (iv) the offense involves property which is confidential as a matter of law.

Offenses against computer equipment or supplies—

1) Whoever willfully, knowingly and without authorization modifies equipment or supplies used or intended to be used in a computer, computer system or computer network commits an offense against computer equipment or supplies.

2) An offense against computer equipment or supplies is a Class B misdemeanor. However, this offense is a Class A misdemeanor if the cost of restoring the equipment or supplies to their condition immediately prior to modification is at least two hundred fifty dollars ($250) but less than two thousand five hundred dollars ($2500), and a Class D felony if (i) the cost of restoration is at least two thousand five hundred dollars ($2500), (ii) the modification causes a substantial interruption or impairment of utility service rendered to the public, (iii) the equipment or supplies belong to a financial institution or bank, or health care facility, or (iv) the modification poses an unreasonable danger to other property or to human life.

3) Whoever willfully, knowingly and without authorization destroys, takes, injures, or damages equipment or supplies used or intended to be used in a computer, computer system, or computer network; or whoever willfully, knowingly and without authorization destroys, injures or damages any computer, computer system, or computer network commits an offense against computer equipment or supplies.

4) The penalties for the offense described in (3) shall be the same as those described in (4) of the section concerning offenses against intellectual property.

Offenses against computer users—

1) Whoever willfully, knowingly and without authorization accesses or causes to be accessed any computer, computer system, or computer network; or whoever willfully, knowingly and without authorization denies or causes to be denied computer system services to an authorized user of such computer system services, which, in whole or part, is owned by, under contract to, or operated for, on behalf of, or in conjunction with another commits an offense against computer users.

2) An offense against computer users is a Class B misdemeanor. However, this offense is a Class D felony if (i) the act causes a substantial interruption or impairment of utility service rendered to the public, (ii) interferes with the operation of a bank, financial institution, or health care facility, or (iii) involves an intent to devise or execute any scheme to obtain by fraud property the value of which exceeds one thousand dollars ($1000).

Chapter not exclusive—Nothing in this chapter shall be construed to preclude the applicability of any other provision of the criminal law of this state which presently applies or may in the future apply to any transaction which violates this chapter, unless such provision is inconsistent with the terms of this chapter.

If any provision of this act or the application thereof to any person or circumstance is held invalid, it is the legislative intent that the invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provisions or applications, and to this end the provisions of this act are declared severable.

Comment

Trial Advocate Competency

*The Honorable Robert H. Staton**

The competency of the trial advocate plays an indispensable role in the administration of justice. Without minimal competency of the trial advocate in the courtroom, no criminal defendant can receive the benefit of effective counsel. Under our system of government by rule of law, the liberty of an accused rests upon a very delicate balance when minimal competency of the trial advocate is placed in question. Equally important is the role of the trial advocate in the adjudication of civil litigation. Without his minimal competency injected, the due process of law equation will never balance within the terms of the United States Constitution and the constitutions of the several states. For these reasons and many more, the public should never hold in doubt the ability of the legal profession to provide minimally competent trial advocates in the courtroom when their services are needed. However, the safeguards for this public assurance are very tenuous. When a law student graduates from law school, he is tested upon the substantive law and never upon his skills as a trial advocate who will soon be entering the courtroom to protect the liberty of an accused or the vital civil interest of his client. Presently, it is assumed that passing of the state bar examination by a law school graduate qualifies him to represent the members of the public in a state or federal courtroom as a trial advocate. Some members of the federal judiciary doubt the validity of this assumption as to all licensed advocates. Many members of the state judiciary as well as members of the state and federal bars join them in their doubts.

Chief Justice Warren Burger of the United States Supreme Court delivered his now famous Sonnett Lecture in 1973 at Fordham Law School.[1] In his lecture, he remarked: "[I]n spite of all the bar examinations and better law schools, we are more casual about qualifying the people we allow to act as advocates in the courtrooms than we are about licensing our electricians."[2]

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*Hon. Robert H. Staton is a judge of the Indiana Court of Appeals and the Executive Secretary of The Indiana Judicial Council on Legal Education and Competence at the Bar. Admission and Discipline Rule 28.

[1]Burger, *The Special Skills of Advocacy: Are Specialized Training and Certification Essential to Our System of Justice?*, 42 FORDHAM L. REV. 227 (1973) (delivered as the Fourth Annual John F. Sonnett Memorial Lecture at the Fordham Law School, New York) (Nov. 26, 1973) [hereinafter referred to as the *Sonnett Lecture*].

[2]*Id.* at 230.

Another doubter in the federal judiciary is Chief Judge Irving R. Kaufman of the United States Court of Appeals for the Second Circuit: "Too many lawyers come into court today with only a diploma to justify their claims to be advocates. They are untrained and unsupervised in the immensely practical work of litigation."[3]

An accused is entitled under the sixth amendment to the assistance of effective trial counsel to protect his liberty during criminal proceedings by the state, but more than a few instances of less than effective trial counsel have been noticed by members of the bench. Chief Judge David L. Bazelon of the United States Court of Appeals for the District of Columbia recently noted these sixth amendment violations: "I come upon these 'walking violations' [of the sixth amendment] week after week in the cases I review."[4]

To what extent does less than minimal competency exist in our nation's courtrooms? Chief Justice Burger has estimated that between one-third to one-half of those advocates who appear in "serious" litigation are less than minimally competent.[5] He did not make an estimate which would include some of the less "serious" cases, but the percentage may be much lower due to the lack of the complexity of those less "serious" cases; perhaps, not more than fifteen or twenty percent would be more accurate. This estimate would be more in keeping with some of the findings of the Clare Report[6] where approximately forty judges of the federal second circuit were interviewed: "The percentage of lawyers criticized for lack of training ranged from 15% to 75%. Eliminating the extremes, it was the consensus of the judges that a substantial percentage of the lawyers trying cases before them lacked basic knowledge in the fundamentals of litigation."[7]

A second report, filed by the Devitt Committee, comes closer to the fifteen or twenty percent estimate.[8] In the spring of 1977, the Devitt Committee sent a questionnaire to 476 federal district judges.[9] One question asked on the questionnaire was: "Do you believe that there is, overall, a serious problem of inadequate trial

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[3]Kaufman, *The Court Needs a Friend in Court*, 60 A.B.A.J. 175, 176 (1974).

[4]Bazelon, *The Defective Assistance of Counsel*, 42 U. CIN. L. REV. 1, 2 (1973).

[5]*Sonnett Lecture, supra* note 1, at 234.

[6]Final Report of the Advisory Committee on Proposed Rules for Admission to Practice, 67 F.R.D. 159 (1975) (Robert L. Clare, Jr., Chairman). This report is commonly known and will hereinafter be referred to as the *Clare Report*.

[7]*Id.* at 164.

[8]Report and Tentative Recommendations of the Committee to Consider Standards for Admission to Practice in the Federal Courts, 79 F.R.D. 187 (1978) (Edward J. Devitt, Chief United States District Judge, Chairman). This report is commonly known and will be hereinafter referred to as the *Devitt Report*.

[9]*Id.* at 193.

advocacy by lawyers with cases in your court?"[10] Of the 387 judges who responded to the questionnaire, 41.3% answered "yes" and 58.7% answered "no."[11]

In another question, the judges were asked to rate the performance of 1,969 lawyers in 848 trials.[12] The judges rated 8.6% of the performances " 'very poor,' 'poor,' and 'not quite adequate.' "[13] The trial performances which fell into these two categories, " 'very poor,' and 'not quite adequate,' " amounted to 16% of the 848 trial performances considered.[14] Another category, "adequate but not better," amounted to another 16.7% of the trial performances considered.[15] The Devitt Committee concluded: "If the 16.7% of performances which were barely adequate are added to those judged inadequate, it leads to the conclusion that 25% of the performances were less than 'good.' "[16] If consideration is given to the "serious" cases only estimate of Chief Justice Burger, the Devitt Committee estimate of twenty-five percent and the Chief Justice Burger estimate of thirty-three to fifty percent may not be too far from agreement. Although the estimates of less than minimal competency made by Chief Justice Burger, the Clare Report, and the Devitt Report were restricted to federal courts, it is reasonable to assume that most of these same trial advocates practice in state courts and that similar estimates might be expected if state courts were surveyed.

Basic skills are lacking in most of the trial performances that have shown less than minimal competency including the lack of skill in questioning witnesses on direct examination and on cross-examination, in the making of proper objections to testimony and exhibits, and in making the proper procedural motions. In his Sonnett Lecture, Chief Justice Burger made these five observations:

> 1. The thousands of trial transcripts I have reviewed show that a majority of the lawyers have never learned the seemingly simple but actually difficult art of asking questions so as to develop concrete images for the fact triers and to do so in conformity with rules of evidence.
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> 2. Few lawyers have really learned the art of cross-examination, including the high art of when not to cross-examine.
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> 3. The rules of evidence generally forbid leading questions, but when there are simple undisputed facts, the

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[10] *Id.* at 194.
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*

leading-questions rule need not apply. Inexperienced lawyers waste time making wooden objections to simple, acceptable questions, on uncontested factual matters.

4. Inexperienced lawyers are often unaware that "inflammatory" exhibits such as weapons or bloody clothes should not be exposed to jurors' sight until they are offered in evidence.

5. An inexperienced prosecutor wasted an hour on the historical development of the fingerprint identification process discovered by the Frenchman Bertillon, until it finally developed that there was no contested fingerprint issue. Such examples could be multiplied almost without limit.[17]

During the public hearings held by the Clare Committee to determine whether any trial advocacy inadequacies actually existed in the federal court system, a former United States Attorney testified that "of the last twelve cases he tried as U.S. Attorney he was of the opinion that one-half of the defendants were convicted because of incompetency of their counsel."[18] Later, because he was so moved by the inadequacies of defense counsels, he resigned as United States Attorney and became the first head of the Connecticut Criminal Defense Committee.[19]

During the investigation and research by the Devitt Committee, which was trying to determine the extent of the incompetency found by the Clare Committee, two general areas of inadequacy of trial advocates appeared more prominent than any others. First, the trial advocates were inadequate in the general area of trying the lawsuit—"they don't know how to try a lawsuit."[20] They lack " 'proficiency in the planning and management of litigation,' " and they lack sophistication of " 'technique in the examination of witnesses.' "[21] Second, trial advocates appeared to be inadequately trained in the area of the Federal Rules of Procedure and the Federal Rules of Evidence.[22]

Before considering any of the particular causes ascribed by the previously discussed reports to the inadequacies of trial advocacy in

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[17]*Sonnett Lecture, supra* note 1, at 234-35. Chief Justice Burger also noted: "Another aspect of inadequate advocacy—and one quite as important as familiarity with the rules of practice—is the failure of lawyers to observe the rules of professional manners and professional etiquette that are essential for effective trial advocacy." *Id.* at 235.

[18]*Clare Report, supra* note 6, at 166.

[19]*Id.*

[20]*Devitt Report, supra* note 8, at 194.

[21]*Id.*

[22]*Id.*

the courtroom, the general historical development of legal education as it pertains to trial advocacy may be helpful.[23] Certainly, it will draw into sharper focus the underlying currents of concern for increasing the standards of legal education and explain why some basic advocacy skills have suffered as a result of these concerns.

In the colonial period, the trial advocate received his training through the apprentice system which had been inherited from England.[24] He served as a clerk in a law office which may have had one or more additional clerks serving their apprenticeships. His duties were usually routine drafting and copying from the books, but he would accompany an experienced advocate into the courtroom on occasion and observe the proceedings. He learned by observing, asking questions, and by doing what he was told to do in the office and in the courtroom. Admittedly, this kind of training was not standardized nor did it have any recognizable system. It was merely learning by doing, which varied from one law office to another. However, one should not assume that there was a complete absence of control over the quality of the training. The various state bar associations had minimum standards that all aspiring trial advocates had to meet.[25]

> By insisting upon the observation and enforcement of certain minimum standards, the bar to a large extent controlled the profession, including the admission to the study of law and to active practice. This control of admission [in Massachusetts] was exercised by means of an examination before a committee of the bar.[26]

For example, in New Hampshire a candidate of good moral character who had a liberal arts degree and had served as an apprentice for three years would have to pass the bar examination prepared by the bar association.[27] If the candidate did not have a liberal arts degree, he would have had to serve an apprenticeship of five years.[28] In some states, the apprenticeship requirement was as long as seven years.[29] Taking into consideration the body of law to be studied in the law office which was usually limited to Blackstone,

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[23]For a more thorough historical examination, see A. BLAUSTEIN & C. PORTER, THE AMERICAN LAWYER (1954); 1 & 2 A. CHROUST, THE RISE OF THE LEGAL PROFESSION IN AMERICA (1965); Gee & Jackson, *Bridging the Gap: Legal Education and Lawyer Competency*, 1977 BRIGHAM YOUNG L. REV. 695, 719.

[24]Gee & Jackson, *supra* note 23, at 722-25.

[25]*Id.* at 727.

[26]*Id.* at 727-28 (quoting 2 A. CHROUST, *supra* note 23, at 131).

[27]*Id.* at 728.

[28]*Id.*

[29]*Id.*

Kent, and Coke, the apprentice system was fairly well suited to the early colonial setting.

This apprentice system rapidly began to deteriorate for the trial advocate in the late 1820s under the crushing political pressures from the egalitarian philosophy of Jacksonian democracy.[30] This anti-elitist philosophy was very popular among aspiring trial advocates who were anxious to earn a livelihood in the courtroom. Too, the state legislatures were asserting their authority to dictate through legislation the requirements for admission to practice. The tightly held grip of the bar associations upon the standards for admission to practice law weakened and was finally lost. With few exceptions, anyone of "good moral character,"—giving little consideration for his knowledge of the law—was permitted to practice law under the legislatures' scheme of admission to practice.[31] There was no compelling need for the aspiring trial advocate to serve an apprenticeship for three or five years before being admitted to practice, although some private law schools, such as the Litchfield School founded in 1784 by Tapping Reeve,[32] and law lectures at William and Mary, Harvard, and Yale[33] remained available for those who heard a different drummer.

After egalitarianism began to wane, three very distinct events, more than any others, chartered the course for the demise of the apprenticeship system of becoming a trial advocate. The first event was the absorption of the private law schools by the universities.[34] Private schools had been more practical than theoretical in their approach to legal education. They were much more systematic in their approach to legal education than the apprenticeship, but they could not confer prestigious academic degrees which were becoming preferred by those leaders of the profession who were trying to pick up the pieces left from the Jacksonian democracy onslaught. The university, on the other hand, could confer an academic degree at the conclusion of the law school training. Usually, this marriage of the private law school and the university meant an absorption of the private law school's faculty and students as well, so both were happy with the union.

The second event was less visible. Most universities deplored the apprenticeship approach to legal education and felt themselves in direct competition with that system. When Christopher Columbus Langdell was appointed Dean of Harvard Law School in 1870, he in-

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[30] *Id.* at 728-30.
[31] *Id.* at 730.
[32] *Id.* at 726.
[33] *Id.* at 725.
[34] *Id.* at 732-33.

troduced his revolutionary casebook method of teaching legal theory which became the "model and impetus" for academic legal education.[35] This event more than any other spelled the doom of apprenticeship dominance in legal education. To this day, the Socratic method introduced by Langdell remains strong in university law schools across the country.

The third event was the organization of the American Bar Association in 1878. One of the first standing committees was the Committee on Legal Education.[36] Many of the members on this committee were university law school faculty members determined to raise the standards of legal education. They were later assisted in this endeavor by the Association of American Law Schools. It is not the purpose of this Comment to detail the reforms and standards during the first fifty or sixty years of this committee, but generally these new standards were quantitative in nature, dealing with: the length of time for undergraduate study before entering law school, the length of time for graduate study in law school, the size and composition of law libraries, and the requirement of full-time faculties.[37] The effect of these reforms was devastating to the apprenticeship approach of teaching law. The theoretical approach dominated the scene, and those private schools which remained had to comply with the new standards set by the committee. To assure compliance, the committee devised an inspection procedure of each law school before accreditation by the American Bar Association. Some observers still feel that the practical versus theoretical struggle is very much alive. Some of the recent developments in clinical education within the university law schools and the development of continuing legal education programs within the bar associations would give the impression that legal education is in some sort of cycle and is revolving back to more emphasis on the practical skills that were the mainstay of the apprenticeship.

With this very short glimpse over the shoulder at past developments in legal education, a better understanding of more recent criticisms may be possible. In citing the causes for trial advocacy incompetency, Chief Justice Burger listed three fundamental causes:

> First . . . is our historic insistence that we treat every person admitted to the bar as qualified to give effective assistance on every kind of legal problem that arises in life, including the trial of criminal cases in which liberty is at

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[35]*Id.* at 733.

[36]This committee is now called the Section on Legal Education.

[37]Gee & Jackson, *supra* note 23, at 733-43.

stake, civil rights cases in which human values are at stake, and myriad ordinary cases dealing with important private personal interests. It requires only a moment's reflection to see that this assumption is no more justified than one that postulates that every holder of an M.D. degree is competent to perform surgery on the infinite range of ailments that afflict the human animal.

. . . .

A second cause of inadequate advocacy derives from certain aspects of law school education. Law schools fail to inculcate sufficiently the necessity of high standards of professional ethics, manners and etiquette as things basic to the lawyer's function. With few exceptions, law schools also fail to provide adequate and systematic programs by which students may focus on the elementary skills of advocacy. I have now joined those who propose that the basic legal education could well be accomplished in two years, after which more concrete and specialized legal education should begin. If the specialty is litigation, the training should be prescribed and supervised by professional advocates cooperating with professional teachers, for both are needed. A two-year program is feasible once we shake off the heritage of our agricultural frontier that the "young folks" should have three months vacation to help harvest the crops—a factor that continues to dominate our education. The third year in school should, for those who aspire to be advocates, concentrate on what goes on in courtrooms. . . .

. . . .

The third cause is the inevitable inability of prosecutor and public defender offices to provide the same kind of apprenticeships for their new lawyers as, for example, the large law firms provide. The prosecution offices and public defender facilities have neither the wealthy clients nor consequent financial resources of the large law firms to enable them to develop whatever skills they need to carry out their mission. Prosecutors and public defenders often learn advocacy skills by being thrown into trial. Valuable as this may be as a learning experience, there is a real risk that it may be at the expense of the hapless clients they represent—public or private. The trial of an important case is no place for on-the-job training of amateurs except under the guidance of a skilled advocate.[38]

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[38]*Sonnett Lecture, supra* note 1, at 231-33.

The three years of law school education referred to by Chief Justice Burger in his second cause was actually a requirement thought necessary by Langdell, the first to institute the requirement at Harvard. Later, other schools followed Langdell's lead. The American Bar Association debated for almost forty years on the merits of requiring three years of legal education before accepting it as a standard for admission to the bar.[39]

Other causes for inadequate trial advocacy were cited in the Clare Report. Two principal causes which were related to more modern developments rather than historical developments were underscored. The first principal cause cited by the Clare Report was the staggering increase in litigation during the last decade which has created a severe shortage of competent trial advocates to serve the demand of litigants.[40] The Clare Report described the increased demand for trial advocates as follows:

> Today, more than ever, people look to government including the courts for the solution of an ever-increasing number of their social and economic problems.
>
> This coupled with an expanding concept of constitutional rights and a legislative tendency to enact broad social and environmental legislation, leaving implementation to the courts, necessarily results in a heavily increased demand for trial lawyers.[41]

A second principal cause cited by the Clare Report was the demand of students to choose the courses they want to take rather than to be restricted to any required list of courses prepared by the law school.[42] This student demand for freedom of choice has reduced courses such as evidence and legal ethics to elective courses in some law schools.[43] Previously, evidence, legal ethics, and procedures were considered essential to every student's legal education. The Clare Committee expressed this opinion in its report:

> The Committee is of the opinion that all of the evidence demonstrates that incompetence exists, attributable to lack of proper training, and that the public is deceived when the court admits unqualified attorneys to practice. Such admission carries the implied representation that the court is vouching for the lawyer's adequacy to try cases.[44]

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[39]Gee & Jackson, *supra* note 23, at 734.
[40]*Clare Report*, *supra* note 6, at 167.
[41]*Id.*
[42]*Id.*
[43]*See generally id.*
[44]*Id.* at 166.

This implied representation that the court is vouching for the trial advocate's minimum adequacy and the obvious public deception which may result brought about the first remedial action by a state supreme court. In his explanation for the need of Indiana Rule 13,[45]

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[45]IND. R. ADMISS. & DISCP. 13 (commonly called Rule 13). Rule 13 has 10 separate sections. Sections II and V are pertinent to this discussion and read as follows:

II. Purpose

The purpose of this rule is to establish minimal educational prerequisites for the effective assistance of counsel in civil or criminal matters and cases in the State of Indiana, which minimal educational prerequisites shall be held by all persons admitted to the bar of this Court by written examination after the effective date of this rule.

. . . .

V. Educational Qualifications

Each applicant for admission to the bar of this Court by written examination shall be required to establish to the satisfaction of the State Board of Law Examiners that the applicant is

(A) A graduate of a law school located in the United States which at the time of the applicant's graduation was (1) a school of law approved by the Supreme Court of Indiana or an agency thereof; or (2) was a school of law approved by the Supreme Court of any other state of the United States or an agency thereof; or (3) was on the approved list of the Council of Legal Education and Admission to the bar of the American Bar Association (The Supreme Court of Indiana reserves the right to disapprove any school regardless of other approval); and

(B) A person who satisfactorily has completed the law course required for graduation and furnishes to the Board of Law Examiners a certificate from the Dean thereof, or a person designated by the Dean, that the applicant will receive the degree as a matter of course at a future date, pursuant to Indiana Rules of Admission and Discipline, Rule 17, and

(C) A person who has completed in an approved school of law each of the following designated subject matter and cumulative semester hours requirements, *regardless of the course name*, in a law school curriculum:

ADMINISTRATIVE LAW AND PROCEDURE — 3 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:

Administrative Law and Procedure
Federal Trade Commission
Labor Law
Securities & Exchange Commission

BUSINESS ORGANIZATIONS — 4 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:

Agency
Corporations
Partnership

CIVIL PROCEDURE — 6 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:

State and Federal Rules of Civil Procedure
Conflicts of Law
State and Federal Courts

Chief Justice Richard M. Givan wrote: "[I]t was clear that our Court might be certifying persons to practice law in Indiana and for the federal judiciary in Indiana, who were not, in fact, prepared to give the effective legal assistance to their clients who were entitled—whether in civil or criminal matters or cases."[46]

What is probably more important, Indiana Rule 13 awakened the conscience of other supreme courts in the United States and gave them a new sense of duty and responsibility to the public in their states. Constitutional dimensions are attached to this duty and responsibility recognized by Chief Justice Givan:

COMMERCIAL LAW	3 credit-semester hours
CONTRACTS	4 credit-semester hours
CONSTITUTIONAL LAW	3 credit-semester hours
CRIMINAL LAW, CRIMINAL PROCEDURE	4 credit-semester hours
EQUITY	3 credit-semester hours
EVIDENCE	3 credit-semester hours
LEGAL ETHICS	2 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:
- Legal Ethics
- Professional Responsibility

LEGAL RESEARCH AND WRITING — 2 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:
- Legal Bibliography
- Legal Writing
- Legal Memoranda
- Trial or Appellate Brief Writing

PROPERTY — 8 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:
- Future Interests
- Landlord and Tenant
- Personal Property
- Probate Law
- Real Property
- Trusts
- Wills

TAXATION — 4 credit-semester hours*

Some examples of courses which qualify for credit in this subject are:
- Taxation of Business Associations
- Estate and Gift Tax
- Federal Income Tax
- State Tax

TORTS — 4 credit-semester hours

*Any combination of the courses set out under this requirement or similar courses in this subject matter totaling the number of hours required herein will comply with this rule. This is not an exclusive list of courses. It is subject matter and not course name which controls.

[46]Givan, *Indiana's Rule 13: It Doesn't Invite Conformity. It Compels Competency*, 3 LEARNING AND THE LAW 16, 20 (1976).

> By certifying attorneys to practice law, we represent that they are competent to provide effective counsel—on which we insist and to which a client is constitutionally entitled. That representation is not made by any American law school or any law school in Indiana, and it is not made by any bar association . . . .[47]

While some legal educators scoffed at the idea that other state supreme courts would follow Indiana Rule 13 as a model, there appears to be some indication that the contrary is true. One Indiana legal educator made this evaluation: "Rule 13 is an Indiana development having relatively little to do with the improvement of professional skills. Because it contains little to commend it to other jurisdictions, there is good reason to believe that it will not spread beyond the borders of Indiana."[48] Since this evaluation of Rule 13 was made, however, the South Carolina Supreme Court has adopted a Rule 5A[49] which is much more extensive and comprehensive than

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[47]*Id.* at 21.

[48]Boshkoff, *Indiana Rule 13: The Killy-loo Bird of the Legal World*, 3 LEARNING AND THE LAW 18, 19 (1976) (Douglass G. Boshkoff, professor and former dean, Indiana University School of Law, Bloomington).

[49]S.C. R. EXAM. & ADMISS. 5A. Rather than requiring a specific number of hours in each area, South Carolina's Rule 5A merely requires "a course in each of the . . . designated subject matters . . . ." *Id.* South Carolina's Rule 5A also differs from Indiana's Rule 13 by omitting the requirement of a course in administrative law and instead requiring a course in trial advocacy. The rule states in pertinent part:

> No person shall be admitted to the practice of law in South Carolina unless he . . .
>
> . . . .
>
> (5) has completed in such school of law each of the following designated subject matters and cumulative semester hours of requirements, regardless of the course named in a law school curriculum:
>
> (A) CONSTITUTIONAL LAW — 3 credit-semester hours
>
> (B) CONTRACTS — 4 credit-semester hours
>
> (C) PROPERTY — 8 credit-semester hours
>
> Some examples of courses which qualify for credit in this subject are:
> Future Interests
> Landlord and Tenant
> Personal Property
> Probate Law
> Real Property
> Trusts
> Wills
> Estate Planning
>
> (D) LEGAL WRITING AND RESEARCH — 2 credit-semester hours
>
> (E) TORTS — 4 credit-semester hours
>
> An example of a course which qualifies for credit in this subject is:
> Damages

Indiana Rule 13 in its attempt to assure the public that the licensed law school graduates of South Carolina are minimally competent to represent them. The South Carolina Rules Committee stated in its report to the South Carolina Supreme Court:

(F) CIVIL PROCEDURE — 6 credit-semester hours
Some examples of courses which qualify for credit in this subject are:
State and Federal Rules of Civil Procedure
State and Federal Courts
Moot Court
Practice Court

(G) CRIMINAL LAW PROCESS — 4 credit-semester hours

(H) COMMERCIAL LAW — 4 credit-semester hours
Some examples of courses which qualify for credit in this subject are:
Commercial Transactions
Uniform Commercial Code
Sales

(I) BUSINESS ASSOCIATIONS — 4 credit-semester hours
Some examples of courses which qualify for credit in this subject are:
Corporate Finance
Business Planning
Agency
Banking Law
Corporation and Partnership Planning

(J) DOMESTIC RELATIONS — 3 credit-semester hours

(K) PROFESSIONAL RESPONSIBILITY (ETHICS) — 2 credit-semester hours*

(L) EQUITY — 3 credit-semester hours

(M) EVIDENCE — 3 credit-semester hours

(N) ADMINISTRATIVE LAW AND PROCEDURE — 3 credit-semester hours

(O) TRIAL ADVOCACY — 2 credit-semester hours
Some examples of courses which qualify for credit in this subject are:
Criminal Trial Practice
Law Advocacy Skills
Trial Advocacy Clinical Oriented Program

(P) TAXATION — 2 credit-semester hours
Some examples of courses which qualify for credit in this subject are:
Federal Income Tax
Estate and Gift Tax
Corporate Tax

(Q) INSURANCE — 2 credit-semester hours

(R) LEGAL ACCOUNTING** — 2 credit-semester hours

*Three hours are preferable but some law schools offer only 2-hour courses.

**Will not apply if applicant has 6 credit-semester hours in undergraduate or other graduate school in Accounting.

This is not an exclusive list of courses. It is subject matter and not course name which controls. The effective date of the subject matter requirements enumerated hereinabove shall be applicable for all first-time applicants applying to take the bar examination given after July 1, 1981.

> In conducting our study, we have kept in mind the fact, first, that the Constitution of South Carolina imposes upon the Supreme Court the sole responsibility of determining those persons who shall be admitted to the practice of law; secondly, that the law schools, which are the principal instrument for training attorneys, are not controlled by the Supreme Court but that, thirdly, the problem of improving trial advocacy and attorney competency in general is the problem and concern of both. The chore of providing competency is principally that of the law school, although it is to some degree also the concern of the bench and bar; the matter of assuring competency before admission to practice is the work of the Supreme Court.[50]

In addition to required areas of law and related disciplines for admission to practice law, South Carolina's Rule 5B provides:

> An attorney, though admitted to practice, may not appear alone in the actual conduct and trial of a case unless and until he or she has filed with the Clerk of the Supreme Court a certificate (to be supplied by the Court) that he or she has had at least eleven trial experiences.
>
> A trial experience is defined as:
>
> (1) actual participation in a full trial under the direct supervision of a member of the Bar, or
>
> (2) an observation of an entire contested testimonial-type hearing in a South Carolina Tribunal.
>
> The required trial experiences may be gained by any combination of (1) or (2) but must include the following:
>
> 3 civil jury trials in Court of Common Pleas, or 2 in Common Pleas plus 1 in the U.S. District Court and,
>
> 3 criminal trials in General Sessions Court, or 2 in General Sessions plus 1 in the U.S. District Court, and
>
> 1 trial in equity heard by a judge, master, or referee, and
>
> 3 trials in Family Courts, and
>
> 1 trial before an industrial commissioner or other administrative officer.
>
> The certificate shall specify by name the cases and dates and tribunals involved, attested by the respective judges, masters or referees, or hearing officer. The Clerk's ac-

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[50]COMMITTEE TO STUDY THE RULES OF EXAMINATION AND ADMISSION OF PERSONS TO PRACTICE LAW IN SOUTH CAROLINA, REPORT OF COMMITTEE TO STUDY THE RULES OF EXAMINATION AND ADMISSION OF PERSONS TO PRACTICE LAW IN SOUTH CAROLINA (1979).

> knowledgement and approval of the certificate shall be the attorney's authority to thereafter conduct and try cases without the supervision of a member of the Bar.
>
> . . . .
>
> An attorney who has for three years practiced law in another state, and who has been admitted to practice law in South Carolina, may exempt the trial experiences required by submitting proof satisfactory to the Clerk of the South Carolina Supreme Court of equivalent experience in the other state.[51]

There is every reason to believe that Indiana's Rule 13, the first rule by a state supreme court which recognized its constitutional responsibility to the public, will awaken other state supreme courts to their constitutional responsibility in the administration of justice; a constitutional responsibility that extends, as does South Carolina's Rule 5, to the certification of trial advocates.

Another indication of concern by state authorities that their licensees may be less than adequate as trial advocates is the experiment being conducted in California by the Committee of Bar Examiners. The Committee is administering an "alternative assessment" test which is designed to examine the law school graduate in such clinical skills as legal research, client counseling and interviewing, negotiations, and advocacy. Armando Menocal III, chairman of California's Committee of Bar Examiners, commented:

> We all agree that if it is appropriate at all to screen people for the practice of law, the only valid test is one that determines who is competent to practice, so the public is protected. No bar examination has ever been validated as related to fitness to practice law.[52]

Most critics of trial advocacy look to the law schools as the source of the inadequacy and to the law schools as the source of the cure. This approach to the problem of training minimally adequate trial advocates may not be entirely fair. Unlike the Langdell casebook approach, advocacy training requires a very low student-faculty ratio. Very few law schools have sufficient budgetary funds to embark upon such a highly labor-intensified program. Even if the funds were available, obtaining experienced trial advocates to teach in advocacy programs could be a problem when the law school is located a long distance from a large metropolitan area. Many of the

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[51]S.C. R. EXAM. & ADMISS. 5B.

[52]Slonim, *Bar Experiment Could Blaze New Path*, 66 A.B.A.J. 139 (1980).

most experienced trial advocates are in the metropolitan areas. When adjunct professors could be made available from metropolitan areas, law school administrators have not always had a sympathetic faculty to support an advocacy program on a meaningful scale. Too, adjunct professors who are solely dedicated to clinical skill training seldom receive the faculty status and recognition as other members of the faculty who are more concerned with the theory of law and who are publishing regularly to obtain tenure status. A recent report from the American Bar Association Task Force on Lawyer's Competency made this observation:

> The perceived deficiency of law school training lay not in fundamentals—"developing . . . analytical skills and familiarizing . . . with the law in general"—but in the techniques of making those fundamentals operational. The comments on training for trial work stressed the same point. For example, one respondent wrote:
>
> > [L]aw school gave me an excellent background in legal reasoning, writing, and research. However it did not prepare me for the mechanics of trial litigation, to wit, interviewing witnesses, depositions, in other words I had an excellent theoretical background, but as far as putting that background into practical results such as how to try a lawsuit, the format of law school was not helpful.[53]

Chief Justice Burger has recommended that "some system of certification for trial advocates is an imperative and long overdue step."[54] After he had observed the English advocacy system for over twenty years, Chief Justice Burger noted that litigation was conducted in a fraction of the time required for comparable litigation in the United States.[55] He urged the recognition of three basic assumptions:

> What, then, can we learn from the English legal profession? We should first recognize three implicit and basic assumptions about legal training that permeate their system. First: lawyers, like people in other professions, cannot be equally competent for all tasks in our increasingly complex society and increasingly complex legal system in particular;

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[53]ABA SECTION OF LEGAL EDUCATION AND ADMISSIONS TO THE BAR, LAWYER COMPETENCY: THE ROLE OF THE LAW SCHOOLS 18 (1979) (quoting Baird, *A Survey of the Relevance of Legal Training to Law School Graduates*, 29 J. LEGAL EDUC. 264, 270 (1978)).

[54]*Sonnett Lecture*, *supra* note 1, at 227.

[55]*Id.* at 228.

> second: legal educators can and should develop some system whereby students or new graduates who have selected, even tentatively, specialization in trial work can learn its essence under the tutelage of experts, not by trial and error at clients' expense; and third: ethics, manners and civility in the courtroom are essential ingredients and the lubricants of the inherently contentious adversary system of justice; they must be understood and developed by law students beginning in law school.[56]

The Clare Report recommended that trial advocates be separately admitted to federal practice and proposed admission rules to federal district courts[57] and to the Second Circuit Court of Appeals.[58] Study in the following areas of law was suggested as a requirement for admission to federal district courts: evidence, civil procedure, criminal law and procedure, professional responsibility, and trial advocacy.[59] Several objections were made by the law schools to this proposed rule, including contentions that the required subject matters have never been shown to improve trial advocacy and that the rule impinges upon academic freedom.[60] In addition to the balkanization objection which has also been leveled at Indiana Rule 13, the law school objection of costs beyond present budgetary limits was made.[61] It would appear that many of the essential areas of law suggested by the rule are already a part of the law school curriculum and that little additional expense would be required.[62] The Clare Committee answered the law school cost objection by singling out the extensive elective programs found in many of the law schools:

> While the law schools complain of the costs entailed in teaching Trial Advocacy, at the same time they apparently have no difficulty in funding courses in such subjects as "Urban Development", "Macro-economics and the Law", and "Psychoanalysis and the Law" (defined as a "study of the theory of psychoanalysis and its relevance (if any) to the law"). We do not argue that these courses lack value, but we do consider that if the courts and the public are to be adequately served, and if students are demanding training in the technique

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[56] *Id.* at 229-30.

[57] *Clare Report, supra* note 6, at 187-90.

[58] Rule Relating to Practice Before the United States Court of Appeals for the Second Circuit, 67 F.R.D. 192 (1975). This proposed rule was adopted and became effective Jan. 1, 1976.

[59] *Id.* at 188. For a general discussion, see *id.* at 167-70.

[60] *Id.* at 176-80.

[61] *Id.* at 169.

[62] *Id.*

> of litigation and not getting it, then the priorities demand that the necessary resources be diverted to and more emphasis be placed on trial advocacy rather than on more esoteric subjects.[63]

The Devitt Report recommended that law schools expand their trial advocacy programs.[64] It concluded that "law school is the logical place for the future trial lawyer to start learning courtroom skills."[65] Citing a survey sponsored by the American Bar Association, the report noted that eighty-three percent of those polled felt that training in trial advocacy in law school should be mandatory or would be useful.[66]

> But it appears clear that the availability of first rate training does not meet the demand. For example, in another recent study of the graduates of six law schools, approximately thirty percent of the trial lawyers said they had received no law school training in trial advocacy or that which they did receive was not useful.[67]

The Devitt Report further recommended "that as a condition of admission to practice in a United States District Court, the applicant pass an examination in Federal Rules of Civil, Criminal and Appellate Procedure, Federal Rules of Evidence, Federal Jurisdiction and the Code of Professional Responsibility."[68] The Devitt Report also recommended that some prior courtroom experience be demonstrated by an applicant before he is permitted to act as a trial advocate without the assistance or supervision of an experienced trial advocate.[69]

Another recommendation of the Devitt Report was concerned with the lack of specific guidance on competency given by the American Bar Association Code of Professional Responsibility:

> The ABA Code of Professional Responsibility should be reexamined for purposes of clarifying its requirement of competency. Ethical Consideration EC-2-30 of the American Bar Association Code of Professional Responsibility declares that "employment should not be accepted by a lawyer when he is unable to render competent service . . . ." DR 6-101 and

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[63] *Id.*
[64] *Devitt Report*, *supra* note 8, at 201.
[65] *Id.*
[66] *Id.*
[67] *Id.* at 201-02.
[68] *Id.* at 196.
[69] *Id.* at 198.

> EC 6-1 through 6-6 reinforce the professional obligation regarding competence, but the Code lacks specifics as to what might constitute inability to render competent service in relation to representation in trial proceedings.[70]

In 1980, the American Bar Association Committee on Evaluation of Professional Standards published a discussion draft of "Model Rules of Professional Conduct."[71] Although the draft is a vast improvement over previous rules of professional conduct, it lacks the expressed specifics requested by the Devitt Report. Rule 1.1 concerns the lawyer's competence: "A lawyer shall undertake representation only in matters in which the lawyer can act with adequate competence. Adequate competence includes the specific legal knowledge, skill, efficiency, thoroughness, and preparation employed in acceptable practice by lawyers undertaking similar matters."[72] The comment to Rule 1.1 recognizes one of the assumptions that Chief Justice Burger felt so necessary to solving the trial advocacy problem of the practicing bar: "Since no lawyer can be adequately proficient in all areas of the law, a lawyer should undertake only matters within his or her domain of professional skill." Within that domain the lawyer should act in a particular matter with adequate attention, preparation, and thoroughness to discharge the matter properly."[73]

The discussion draft very sensibly cautions that competency of a particular lawyer in a particular legal matter must be viewed on an ad hoc basis rather than attempting to draft a general or all encompassing rule. It further cautions that no precise formula prescribes the knowledge and skill required in any particular matter. The proper standard is the skill and knowledge possessed by lawyers who ordinarily handle such matters."[74] Does this mean the "skill and knowledge possessed by lawyers" in a given community or does it mean a larger geographical area such as the state which originally licensed the lawyer to practice law? If we apply this "proper standard" to trial advocacy, it would appear that the local or county courts should be the "proper standard." A trial judge of the county would appear to be in the best position to fairly administer this standard. Too, a peer review of the trial judge's determination by the local bar would seem most appropriate. If there is a conflict of competency determinations between the trial judge and the local bar peer

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[70] *Id.* at 204.

[71] ABA COMMITTEE ON EVALUATION OF PROFESSIONAL STANDARDS, MODEL RULES OF PROFESSIONAL CONDUCT (1980).

[72] *Id.* at 7.

[73] *Id.*

[74] *Id.* at 9.

review committee, an appeal to a state bar competency committee or to the state supreme court could settle the conflict and make a final determination to cure the incompetency.

This author's view is that enough reports have been made to justify some remedial efforts. Certainly, any initial step should be cautiously taken and carefully measured. The direction of the first step appears obvious. Because the competency of a trial advocate may have to be viewed on an ad hoc basis, any rule should be primarily concerned with the procedure which will identify a display of incompetency in the courtroom and with the means of remedying it for the benefit of the practicing lawyer and the protection of the public.

If a state supreme court did not want to adopt the very adequate and comprehensive South Carolina Rule 5B,[75] it could begin with a simple monitoring rule which is designed to identify incompetency of the trial advocate. This rule would test the incompetency tolerance of the trial judge and the local bar association. It would require that an aspiring trial advocate have one trial judge in his county certify that he is adequately competent to represent the public in the courtroom as a trial advocate. This certification could be waived in those instances in which the lawyer has appeared before a trial judge in the county many times before and there is no further need to demonstrate his competency as a trial advocate. On the other hand, if a lawyer is not certified by a trial judge of the county and if he has not tried a contested matter before any court, the rule should require that the first-time trial advocate be assisted by a certified trial advocate until he demonstrates to the trial court his competency to be certified. Any rule of certification should indicate whether the advocate is certified as to court trials or jury trials. It would seem appropriate that a certification for each type of trial—civil court, criminal court, civil jury, and criminal jury—would be advisable.

Once competency or incompetency is identified by the trial judge, the rule should provide for a peer review committee which should consist solely of members from the local bar association who are certified advocates. Any determination made by the trial judge should be reviewed by the peer review committee, and it should make recommendations to the lawyer whose certification is being withheld so that he may be certified by the trial judge as soon as possible. If the lawyer does not agree with the trial judge or the peer review committee's determination of his competency to practice as a trial advocate, he should have an appeal process available

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[75]*See* note 37 *supra* and accompanying text.

to him. This appeal could be taken before the state bar competency committee for a review. In Indiana, for example, if the lawyer was still dissatisfied with the determination of the state bar competency committee, he could petition the Indiana Judicial Council on Legal Education and Competence at the Bar and file the record of the proceedings before the state competency committee. The Judicial Council could review the record, hear argument, and make its recommendation to the Indiana Supreme Court. A rule encompassing these procedures would provide minimal safeguards for the public and for the lawyer who wishes to practice as a trial advocate.

The state bar association should have a continuing legal education program in trial advocacy available in this review procedure so that any identified incompetency or inadequacy could be quickly remedied to everyone's satisfaction. The attendance of a lawyer at such a continuing legal education program should qualify him for certification without further action on the part of the trial judge. However, certification of a trial advocate would always be subject to review by the trial judge and the peer review committees.

If trial advocacy is to be improved in our courtrooms, some remedial action must be taken now. The public interest and the self-interest of the legal profession demand some immediate action. There is good reason to believe that some action in the form of a rule will be taken by the federal judiciary and that the Devitt Report will have considerable influence on the formulation of the rule. Many of the same lawyers who practice in the federal courts also practice in the state courts. If any of the lawyers fail to comply with the federal advocacy rule because of some inadequacy in their training, they will be free to practice in the state courts unless the state supreme courts formulate a rule to assure minimal competency of state trial advocates as well.

The state supreme courts have been in the forefront in taking meaningful action to assure the public of minimal competency. Indiana Rule 13 and South Carolina Rule 5A are outstanding examples. If a rule is to be drafted to assure minimal competency in the courtroom, it would appear that the state supreme court should be the source of the rule because it is the licensing authority for the practice of law. If state supreme courts around the country act now, there may be very little need for the federal judiciary to enter a field of rule making which has been traditionally left to the state supreme courts.[76]

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[76]Chief Justice Burger noted in his *Sonnett Lecture*:

> Some system of specialist certification is inevitable and, as we know, it has been discussed in legal circles for a generation or more. Dean Robert B. McKay of New York University Law School has observed that the legal profession has "marched up the hill of specialist certification only to march right

down again in the face of opposition from practitioners not discontent with the absence of regulation." Our commitment to the public and to the system of justice must not let us be marched down that hill any longer.

I see nothing for lawyers, litigants, or courts to fear, and on the contrary I see a great potential gain, by moving toward specialist certification to limit admission to trial practice, beginning in courts of general jurisdiction where the more important claims and rights are resolved. When we have succeeded in that limited area we can then examine broader aspects of specialization. Furthermore, while the legal profession must obviously lead in this effort, the interests of the public dictate that the views of practitioners who are affected cannot be controlling any more than we allow the automobile or drug industry to have complete control of safety or public health standards. There are more than 200 million potential "consumers" of justice whose rights and interests must have protection, and it is the duty of the legal profession to provide reasonable safeguards—unless lawyers prefer regulation from the outside.

Sonnett Lecture, *supra* note 1, at 238-39 (footnote omitted).

Notes

Examining the Policies for Applying the Criminal Defendant Privilege to Removal Actions

The United States Constitution provides that "[n]o person . . . shall be compelled in any criminal case to be a witness against himself."[1] Over the years, these words have spawned a bifurcated "privilege," one aspect protecting the witness' right in any proceeding from being compelled to incriminate himself and the other aspect protecting the right of the accused in any criminal proceeding from being compelled to take the stand.[2] One commentator has summarized: "In the case of an ordinary witness the questions may be asked. He may then decide whether he will exercise the privilege. . . . On the other hand, the defendant in a criminal case has the privilege of refusing to give any testimony in the case."[3] The latter privilege, which will be referred to as the criminal defendant privilege, may apply in other contexts that resemble criminal actions. The recent public interest in using removal proceedings to remove derelict public officers invites discussion about whether such officers are entitled to invoke the criminal defendant privilege. This Note will determine whether the criminal defendant privilege not to take the stand in a particular case applies to judicial proceedings maintained to remove derelict public officers. Before proceeding to that analysis however, an inquiry into the history of removal proceedings is necessary.

I. A Brief History of Judicial Removal of Officers

The historical evolution of modern removal statutes may explain the uncertainty concerning the applicability of such procedural safeguards as the criminal defendant privilege to removal proceedings. At early English common law, a public official could be removed for misconduct or neglect either by a criminal action[4] or by

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[1]U.S. Const. amend. V.

[2]*See* McCarthy v. Arndstein, 266 U.S. 34, 40 (1924); United States v. Housing Foundation of America, Inc., 176 F.2d 665, 666 (3d Cir. 1949).

[3]1 C. McCormick & R. Ray, Texas Law of Evidence § 432 (2d ed. 1956).

[4]4 W. Blackstone, Commentaries *141; J. Story, Commentaries on the Constitution of the United States § 800 (5th ed. 1891). This common law authorization of removal in a criminal action or in a totally independent action was undoubtedly the precursor of many state statutes mandating the same two mechanisms to deal with unworthy public officers. *See, e.g.*, Criminal Code of 1961 § 33-3, Ill. Ann. Stat. ch. 38, § 33-3 (Smith-Hurd Supp. 1979); Mont. Rev. Codes Ann. § 94-7-401 (Supp. 1977). Both statutes define the offense of official misconduct and provide penalties, including removal from office, without affecting any common law power of removal.

a writ of *quo warranto*, which theoretically could be brought by an individual in the King's name.[5] If a criminal action was brought, the public officer faced removal from office as well as a substantial fine.[6] In a *quo warranto* proceeding, judgment was rendered either for the King, in which event the officer was ousted, or for the officer, in which case he retained his office.[7] An officer removed by *quo warranto* also faced a nominal fine.[8] Although the writ was issued "for the King," the action was considered to be civil in nature because the penalty was intended to protect the public rather than punish the officer.[9] The *quo warranto* proceeding, however, possessed the serious drawback of being nonappealable.[10] Consequently, the writ in *quo warranto* was replaced by the writ in nature of *quo warranto*. The writ in nature of *quo warranto* originally was considered to be criminal in nature because the action was introduced by information filed by the government.[11] Nevertheless, the proceeding gradually assumed a civil flavor because the remedy was intended primarily to protect the citizenry.[12] Moreover, the proceeding lacked many of the procedural safeguards associated with criminal

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[5]*See* 3 W. BLACKSTONE, COMMENTARIES *264.

[6]4 *id.* at *141; J. STORY, *supra* note 4, § 800.

[7]3 W. BLACKSTONE, COMMENTARIES *263.

[8]Ames v. Kansas, 111 U.S. 449, 460-61 (1884) (quoting 3 W. BLACKSTONE, COMMENTARIES *263).

[9]*See* Ames v. Kansas, 111 U.S. at 460 (citing Rex v. Marsden, 3 Burr. 1812, 1817, 97 Eng. Rep. 1113, 1115 (K.B. 1765)); Annot., 119 A.L.R. 725, 726 (1939). *See also* BLACK'S LAW DICTIONARY 1131 (5th ed. 1979).

[10]3 W. BLACKSTONE, COMMENTARIES *263.

[11]Ames v. Kansas, 111 U.S. at 460; 3 W. BLACKSTONE, COMMENTARIES *263. Interestingly, Blackstone contended that an English statute, An Act for Rendering the Proceedings upon Writs of Mandamus and Informations in the Nature of *Quo Warranto* More Speedy and Effectual, 1710, 9 Anne, c. 20, §§ IV-VIII, permitted an information in nature of *quo warranto* to be filed by *any* person desiring to maintain an action against one who had allegedly usurped, intruded into, or unlawfully held any franchise or office in a city, borough, or town. 3 W. BLACKSTONE, COMMENTARIES *264. The person maintaining the action was styled the *relator* and in case of judgment for him the defendant was ousted and a fine assessed. *Id.* Blackstone's recognition that an individual could bring the suit undoubtedly influenced the development of the proceedings in the United States. The official titles of these proceedings often vary, although many courts hold that the action should be brought in the state's name. *See, e.g.*, Cline v. Superior Court, 184 Cal. 331, 342, 193 P. 929, 933 (1920); State v. Gooding, 22 Idaho 128, 130, 124 P. 791, 792 (1912); Meyer v. Tunks, 360 S.W.2d 518, 520 (Tex. 1962). People *ex rel.* Dorris v. McKamy, 168 Cal. 531, 143 P. 752 (1914), involved a judicial proceeding to remove Bakersfield's Marshall, McKamy, and was commenced on the accusation of the relator Dorris, a private citizen who was also known as an informer. Thurston v. Clark, 107 Cal. 285, 40 P. 435 (1895), decided by the same court as *McKamy*, is styled in sharp contrast, although the object of both suits was identical: removal of a derelict officer.

[12]*See* Ames v. Kansas, 111 U.S. at 460-61; 3 W. BLACKSTONE, COMMENTARIES *263.

cases because the fine was nominal[13] and because the writ contemplated a more summary procedure.[14]

American courts subsequently incorporated only the writ in nature of *quo warranto* into its common law.[15] As did the English courts, their American counterparts treated the writ as a civil matter[16] with minimal exception.[17] The adoption of modern removal statutes has, in large part,[18] replaced the writ system. However, the modern removal system inherits from its common law parents some of the uncertainty about whether a removal is criminal or civil in nature. Typically, judicial removal of a public officer may be instituted by a grand jury,[19] county attorney,[20] or private citizen upon a verified, written accusation.[21] Some removal statutes provide not only for removal but also fines.[22] A few courts view the fine as a penalty, justifying their conclusion that the removal proceeding is a criminal matter.[23] Other courts view such fines in the same light as those awarded in *quo warranto* proceedings—a mere incident of a civil action.[24] When the particular removal statute does not authorize a money judgment some courts contend that the statute is of some aid in determining whether the action possesses the attributes

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[13]Ames v. Kansas, 111 U.S. at 460-61 (quoting 3 W. BLACKSTONE, COMMENTARIES *263).

[14]3 W. BLACKSTONE, COMMENTARIES *263.

[15]*See, e.g.*, Standard Oil Co. v. Missouri, 224 U.S. 270, 282-83 (1912).

[16]*See id.* at 283; Ames v. Kansas, 111 U.S. at 461.

[17]*See* Standard Oil Co. v. Missouri, 224 U.S. at 283. The Court in *Standard Oil* stated that Rhode Island viewed the remedy and proceeding as criminal in nature (citing State v. Kearn, 17 R.I. 391, 22 A. 1018 (1891)). *See also* Ames v. Kansas, 111 U.S. at 461. The *Ames* Court listed Arkansas, Illinois, New Jersey, New York, and Wisconsin as having deemed the proceeding civil regarding all matters except jurisdiction and pleading. *Id.* (citing State v. Ashley, 1 Ark. 279 (1839); State v. Roe, 26 N.J.L. 215 (1857); People v. Jones, 18 Wend. 601 (N.Y. 1836); Attorney Gen. v. Utica Ins. Co., 2 Johns. Ch. 370 (N.Y. 1817); State v. West Wis. Ry., 34 Wis. 197 (1874)). *Cf.* Annot., 119 A.L.R. 725, 726 (1939) (*quo warranto* actions are civil and not criminal).

[18]Despite the number of states with statutory authority controlling judicial removal of public officers, a surprising amount of case law exists pertaining to writs in *quo warranto* and in nature of *quo warranto*. The principal question raised in these cases is whether the writ will lie. In most jurisdictions, *quo warranto* will not lie when a statutory method of removal exists because the statutory remedy is exclusive. State v. Wymore, 343 Mo. 98, 116, 119 S.W.2d 941, 949 (1938) (quoting State v. Wallbridge, 119 Mo. 383, 393, 24 S.W. 457, 459 (1893)).

[19]*E.g.*, N.M. STAT. ANN. § 10-4-3 (1978).

[20]*E.g.*, UTAH CODE ANN. § 77-7-2 (1978).

[21]*E.g.*, IND. CODE § 5-8-1-35 (1976).

[22]Act of Mar. 14, 1853, ch. 29, § 4, 1853 Cal. Stats. 41 (repealed 1929); IDAHO CODE § 19-4115 (1979); IND. CODE § 5-8-1-35 (1976).

[23]*See, e.g.*, Daugherty v. Nagel, 28 Idaho 302, 308, 154 P. 375, 376 (1915).

[24]*See, e.g.*, Wheeler v. Donnell, 110 Cal. 655, 657, 43 P. 1, 1 (1896).

of a criminal action warranting special procedural safeguards.[25] Determining whether an action is civil or criminal, on the basis of a fine or the lack thereof, is a crude method of deciding whether procedural safeguards such as the criminal defendant privilege attach to a removal proceeding because it ignores the policies underlying that privilege.

II. Availability of Criminal Defendant Privilege in Removals

A. The Labeling Approach

The availability of the criminal defendant privilege in gray areas such as the removal proceeding is subject to debate because the United States Supreme Court has never clearly addressed the issue.[26] Nevertheless, the Court and some lower federal and state courts, have decided that the privilege generally applies in criminal,[27] quasi-criminal,[28] penal,[29] and forefeiture[30] proceedings. The courts have generalized that the inherently punitive nature of these

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[25]*See, e.g.*, Territory v. Sanches, 14 N.M. 493, 500, 94 P. 954, 956 (1908); Skeen v. Craig, 31 Utah 20, 26, 86 P. 487, 488 (1906).

[26]*See* State v. Marion Probate Court, 381 N.E.2d 1245 (Ind. 1978). Although dealing with the availability of the criminal defendant privilege in a civil commitment case, the Indiana Supreme Court stated that the question of whether one may refuse to testify in any proceeding which may result in the deprivation of his liberty had been expressly reserved by the United States Supreme Court. *Id.* at 1247 (citing McNeil v. Director of Patuxent Inst., 407 U.S. 245 (1972)).

[27]Boyd v. United States, 116 U.S. 616 (1886); Standard Oil Co. v. Roxana Petroleum Corp., 9 F.2d 453 (S.D. Ill. 1925) (dicta). In *Boyd*, the Court held the criminal defendant privilege applicable in a proceeding seeking the forefeiture of certain property that the defendant fraudulently obtained. 116 U.S. at 634. Recognizing the punitive aspect of the action, the Court reasoned that even though the action was civil in form, it was criminal in nature. *Id.* at 633-34. Viewing the privilege from the reverse perspective, the *Roxana* court held the privilege inapplicable in a patent infringement case. The court stated that the privilege pertains only to criminal cases and that a patent suit is not such a case. 9 F.2d at 455.

[28]Commonwealth v. Rohanna, 167 Pa. Super. Ct. 338, 74 A.2d 807 (1950). The court in *Rohanna* reversed the trial court decision compelling the defendant to take the stand in an action to compel support payments. *Id.* at 341, 74 A.2d at 809. Thus, "[i]n a . . . quasicriminal proceeding, the defendant may not be called . . . as on cross-examination or otherwise, in violation of his constitutional privilege." *Id.* at 340, 74 A.2d at 808.

[29]Lees v. United States, 150 U.S. 476 (1893). *Lees* involved the applicability of the criminal defendant privilege in a proceeding to collect a $1,000 penalty for violation of the importation and migration laws. The Court, recognizing the punitive aspect of the suit, pierced the civil form and held the privilege to be applicable. *Id.* at 480. *See also* note 37 *infra*.

[30]United States v. United States Coin & Currency, 401 U.S. 715 (1971). Emphasizing the punitive character of the action, the Court in *Coin & Currency* held the criminal defendant privilege available in an action seeking the forefeiture of money for failure to pay the appropriate gambling tax. *Id.* at 722.

matters requires extra procedural safeguards like the criminal defendant privilege.[31] On the other hand, the privilege is unavailable when the matter involves civil[32] or remedial[33] proceedings. Instead of being primarily punitive in character, civil and remedial matters serve other important societal objectives, thereby justifying relaxed and streamlined procedures.[34] In sum, courts have focused on the nature and effect of the proceedings, relying on criminal-civil and penal-remedial distinctions to determine whether the privilege applies.[35] As one might guess, the few state courts which have ruled on the applicability of the criminal defendant privilege in judicial proceedings to remove public officers have generally resorted to these classification devices.

The process of labeling actions as worthy of the criminal defendant privilege, however, ignores the policies and reasons for invoking the privilege in the first place. The labeling device has already been rejected as an absolute standard for invoking the general witness privilege against self-incrimination. The United States Supreme Court, in *In re Gault*,[36] held that "the feeble enticement of the 'civil' label-of-convenience" was not dispositive of the alleged violation of Gerald Gault's witness privilege against self-incrimination because labeling disregards substance.[37] *Gault* involved a juvenile delinquency proceeding in which Gault was committed to an institution as a

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[31]*See* notes 27-30 *supra* and accompanying text.

[32]Capital Prods. Corp. v. Hernon, 457 F.2d 541 (8th Cir. 1972); Loufakis v. United States, 81 F.2d 966 (3d Cir. 1936). In *Capital Prods. Corp.*, the court decided that the criminal defendant privilege did not apply in a proceeding in aid of execution of judgment. 457 F.2d at 542. The plaintiff's interest in obtaining the defendant's answers outweighed the defendant's interest in remaining silent because "[t]here is no blanket Fifth Amendment right to refuse to answer questions in noncriminal proceedings." *Id.* Similarly, the court in *Loufakis* held that deportation proceedings are civil and that therefore the privilege did not obtain. 81 F.2d at 967.

[33]Commissioner v. Mitchell, 303 U.S. 391 (1938). In *Mitchell*, the Court considered a suit seeking an income tax deficiency and a 50% addition for fraud. *Id.* at 395. The Court held that the suit was remedial in nature because it was instigated primarily to protect the revenue and reimburse the government for its loss and investigatory expenses. *Id.* at 401. Also, the Court stated that in such a case "the defendant has no constitutional right . . . to refuse to testify." *Id.* at 403-04 (footnote omitted).

[34]*See* notes 32-33 *supra* and accompanying text; note 73 *infra* and accompanying text.

[35]*See* Thurston v. Clark, 107 Cal. 285, 40 P. 435 (1895); Daugherty v. Nagel, 28 Idaho 302, 154 P. 375 (1915); State v. Borstad, 27 N.D. 533, 147 N.W. 380 (1914); Meyer v. Tunks, 360 S.W.2d 518 (Tex. 1962).

[36]387 U.S. 1 (1967).

[37]*Id.* at 49-50. The Court reached a similar conclusion in Lees v. United States, 150 U.S. 476 (1893). Although recognizing that violations of an importation statute are grounds for a civil action, the *Lees* Court reasoned that "this, though an action civil *in form*, is unquestionably criminal *in its nature*, and in such a case, a defendant cannot be compelled to be a witness against himself." *Id.* at 480 (emphasis added).

juvenile delinquent. Gault subsequently requested an Arizona superior court to grant a writ of habeas corpus. The juvenile court judge testified at the habeas corpus hearing that he recalled that Gault had made certain admissions after being taken into custody. The superior court dismissed the writ. Gault's parents asked the Arizona Supreme Court to review the dismissal on a number of grounds, including fifth amendment violations, because Gault was not advised of his right not to incriminate himself when he made his admissions. The Arizona Supreme Court, however, ruled that Gault did not have a witness privilege in a delinquency proceeding.[38] On appeal, the United States Supreme Court reversed the Arizona Supreme Court.[39] In considering the fifth amendment issue, the Court observed that the general privilege not only assures that admissions are truthful statements and not the "mere fruits of fear or coercion" but also limits the state's power to overcome an individual's "freedom to decide whether to assist the state in securing his conviction."[40] The Court stated that the process of categorizing a claim as civil or criminal is an "entirely unrealistic" method of determining whether the fifth amendment applies,[41] reasoning that a delinquency commitment is nothing more than an incarceration that violates the broad fifth amendment guarantees of individual freedom.[42]

The principles enunciated in *Gault* provide convincing precedent for reaching similar conclusions about the criminal defendant privilege. Classification of a proceeding as criminal or civil may afford some assistance in deciding whether the criminal defendant privilege is available in a removal proceeding, but it is by no means determinative. The substance or nature of a judicial proceeding to remove a public officer represents only a starting point in determining whether the privilege applies.

Nevertheless, four courts have resorted to a number of definitional devices to determine whether the criminal defendant privilege applies to removal proceedings. The four courts are split as to the availability of the privilege.

The California Supreme Court considered the availability question in *Thurston v. Clark*,[43] decided in 1895. The informer, Thurston,

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[38]*In re* Gault, 99 Ariz. 181, 407 P.2d 760 (1965), *rev'd*, 387 U.S. 1 (1967).

[39]*In re* Gault, 387 U.S. 1, 59 (1967).

[40]*Id.* at 47. The fifth amendment witness privilege against self-incrimination represents "the respect a government—state or federal—must accord to the dignity and integrity of its citizens." Miranda v. Arizona, 384 U.S. 436, 460 (1966). The witness privilege embodies "values reflecting the concern of our society for the right of each individual to be let alone." Tehan v. Shott, 382 U.S. 406, 416 (1966).

[41]387 U.S. at 49.

[42]*Id.* at 49-50.

[43]107 Cal. 285, 40 P. 435 (1895).

instituted a statutory action[44] for the removal of the sheriff of Glenn County for official misconduct. Over the sheriff's objections, the trial court compelled the defendant to take the stand. The sheriff subsequently was removed from office. On appeal, the supreme court in considering the privilege issue hesitated to classify the action, stating that it was "a nondescript, but resembling somewhat a *qui tam* action."[45] The court held, however, that the proceeding had as "its aim and object, a process for the punishment of crime,"[46] and that the criminal defendant privilege applied in "all cases in which the action prosecuted is not to establish, recover, or redress private and civil rights, but to try and punish persons charged with the commission of public offenses."[47] The court did not define the "crime" the defendant had committed, thus intimating application of the common law rule that misconduct in office was a criminal offense.[48] The court apparently disregarded the civil form of the proceeding and emphasized its criminal nature. Therefore, the California Supreme Court held that the trial court committed reversible error in compelling the defendant to testify. The foundation of *Thurston* is two-fold: first, a judicial proceeding to remove a public officer affords a public, as opposed to a private, remedy; second, removal is essentially a punishment for misconduct in office. In effect, the *Thurston* court classified the removal proceeding as a criminal matter, justifying the application of the criminal defendant privilege.

In *Daugherty v. Nagel*,[49] the Supreme Court of Idaho in 1915 reached the same result as the *Thurston* court. Nagel, a member of the Board of Bonner County Commissioners, was accused of malfeasance in office. His removal was sought by a Bonner County resident and taxpayer. At trial, the defendant objected to being called as a witness, contending that the removal proceeding was in nature and effect a criminal prosecution within the meaning of the self-incrimination provision of the Idaho Constitution.[50] The objection was sustained, and the issue was appealed. The Idaho Supreme Court upheld the lower court, applying the rationale developed in *Thurston*.[51]

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[44]Act of Mar. 14, 1853, ch. 29, § 4, 1853 Cal. Stats. 41 (repealed 1929).

[45]107 Cal. at 289, 40 P. at 436. A *qui tam* action is one brought by an informer under a statute establishing a penalty for the commission or omission of a certain act and is maintained for the state as well as for the informer. BLACK'S LAW DICTIONARY 1126 (5th ed. 1979).

[46]107 Cal. at 289, 40 P. at 436.

[47]*Id.*, 40 P. at 437.

[48]*See* note 4 *supra* and accompanying text.

[49]28 Idaho 302, 154 P. 375 (1915).

[50]IDAHO CONST. art. I, § 13.

[51]Under the Idaho removal statute, IDAHO CODE § 19-4115 (1979), the taxpayer must allege that the officer "has been guilty of charging and collecting illegal fees for

One year prior to *Nagel*, the Supreme Court of North Dakota reached the opposite result in *State v. Borstad*.[52] At trial, the defendant was called as a witness by the plaintiff and was compelled to take the stand. Although the North Dakota Supreme Court reached a different result, the court approached the problem in much the same manner as the California court in *Thurston*, stating that the removal proceedings were "neither civil nor criminal, but of a character peculiar to themselves."[53] The *Borstad* court, however, concluded that the removal statutes[54] contained their own due process of law. The court explained that such construction was necessary to avoid "technicalities" that might undermine the public's efforts to remove incompetent and dishonest officials. The court observed that "[t]he object of the statute[s] is to protect the public from corrupt officials, and not to punish the offenders,"[55] thereby excusing the need for procedural safeguards such as the criminal defendant privilege.[56] In considering the officer's due process rights under the removal statute, the court held that the removal statute authorized examination of the challenged officer, that the action was civil, and that therefore the trial court did not err in compelling the officer to take the stand.[57] The judgment of removal was accordingly affirmed. Despite the difference in result from the *Thurston* court, the *Borstad* court also applied a labeling approach, emphasizing that a removal proceeding is a civil matter designed to protect the public rather than punish the officer.

Also at odds with the results in *Thurston* and *Nagel* is the 1962 decision of the Texas Supreme Court in *Meyer v. Tunks*.[58] Meyer,

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services rendered or to be rendered in his office, or has refused or neglected to perform the official duties pertaining to his office." 28 Idaho at 307, 154 P. at 376. The court construed the statute as authorizing institution of the suit by a taxpaying private citizen only when malfeasance or nonfeasance was charged. *Id.* at 308-09, 154 P. at 377. Hence, the judgment for the defendant was affirmed. *Id.* at 312, 154 P. at 378. The decisions in *Thurston* and *Nagel* were based in part upon the United States Supreme Court's reasoning in Boyd v. United States, 116 U.S. 616 (1886), that a civil information, filed against Boyd for evasion of import taxes, was criminal in substance and effect because a forfeiture was incurred. *Id.* at 634-35. The Court therefore held that compelling Boyd to produce his private books and papers violated the criminal defendant privilege. *Id. See also* note 27 *supra*.

[52]27 N.D. 533, 147 N.W. 380 (1914).

[53]*Id.* at 537, 147 N.W. at 381.

[54]N.D. CENT. CODE §§ 44-10-01 to -21 (1978).

[55]27 N.D. at 537, 147 N.W. at 381 (citing Ponting v. Isaman, 7 Idaho 283, 62 P. 680 (1900)). *Ponting* was virtually overruled by *Nagel* and its companion line of cases. *See* Daugherty v. Nagel, 28 Idaho at 307, 154 P. at 376.

[56]27 N.D. at 537-38, 147 N.W. at 381-82.

[57]*Id.*

[58]360 S.W.2d 518 (Tex. 1962). During the pendency of the removal action, Meyer was under indictment for bribery and for false representations in his campaign expense and contribution statement.

the sheriff of Jefferson County, sought to overturn the lower court's refusal to quash the adverse party's application to depose Meyer in a removal action pending against him for official misconduct. Meyer contended that the criminal defendant privilege precluded the compulsory taking of his deposition. The court denied his petition for mandamus and held that the Texas version of the fifth amendment[59] did not apply to removal proceedings. The court stated that the character of the proceeding was determined "by the object sought to be accomplished and the nature of the judgment to be entered."[60] The court held that the object of the suit was "not to punish the officer for his derelictions or for the violation of a criminal statute but to protect the public in removing from office by speedy and adequate means those who have been faithless and corrupt and have violated their trust."[61] The court contradicted itself by declaring that "the law imposes no *other penalty*."[62] Thus, the court implicitly recognized the punitive element of a removal proceeding. Nevertheless, the court considered the punitive element to be outweighed by other factors, stating that "the Legislature has plainly provided that [a removal proceeding] . . . is to be tried under the Rules of Civil Procedure rather than of the Code of Criminal Procedure."[63] Despite ambiguities in the analysis, the *Meyer* court's holding that the matter is civil in nature typifies the definitional logic rejected by the United States Supreme Court in *Gault*. In short, these four decisions overemphasize the character of the action and ignore important policy considerations in determining whether the criminal defendant privilege applies.

B. A Policy Approach

Properly viewed, privileges are an ineffective means of discovering the truth; instead, they protect important societal interests.[64] Indeed, society's interest in not forcing defendants in criminal cases to testify against themselves overrides the strong probability that they could furnish valuable and necessary evidence. Although courts and scholars have devoted considerable attention to analyzing the underlying policies of the self-incrimination privilege, generally, they have ignored the justification for an additional privilege for criminal defendants. These sources have not distinguished the

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[59]*See* TEX. CONST. art. I, § 10.

[60]360 S.W.2d at 520.

[61]*Id.*

[62]*Id.* (emphasis added).

[63]*Id.* at 521.

[64]MCCORMICK'S HANDBOOK ON THE LAW OF EVIDENCE § 72 (2d ed. E. Cleary 1972) [hereinafter cited as MCCORMICK].

witness privilege from the criminal defendant privilege when explaining the rationale for the policies.[65] Nevertheless, a few commentators and courts have suggested some rather convincing reasons for the criminal defendant privilege. Viewing the criminal defendant privilege as a necessary ingredient of the American criminal system, Dean Wigmore has suggested that the privilege satisfies the notion that no one should be convicted unless the prosecution has borne the entire burden of proof.[66] If the defendant were compelled to take the stand, he could relieve the prosecution of that burden. Although the defendant would retain the witness privilege not to answer incriminating questions, a genuine fear exists that the defendant would be so intimidated on the stand that he would be incapable of effectively exercising that privilege.[67] Ostensibly, the criminal defendant privilege is intended to equalize the criminal process by removing the inherent advantage that prosecutors would enjoy by compelling the defendant to be a source of proof.[68]

Dean McCormick has suggested that the defendant's mere presence on the stand may create an appearance of guilt.[69] The pressures inherent in a criminal proceeding are likely to make the defendant excessively timid and nervous in responding to the prosecutor's questions. As a result, a defendant's speech or mannerisms may be misconstrued as signs of guilt. Thus, the criminal defendant privilege reflects society's awareness that all individuals, regardless of their innocence, can be found guilty by misleading appearances and impressions created by a criminal proceeding.

Perhaps the most important policy underlying the criminal defendant privilege is the human instinct of self-preservation.[70] In Dean McCormick's words, "[t]o place an individual in a position in which his natural instincts and personal interests dictate that he should lie and then to punish him for lying, or for refusing to lie or violate his natural instincts, is an intolerable invasion of his personal dignity."[71] Absent the privilege, the state theoretically can force one to commit perjury and then impose a punishment for such an indiscretion.[72] Therefore, the privilege preserves an individual's integrity.

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[65]*See, e.g.*, Miranda v. Arizona, 384 U.S. 436, 458-61 (1966); E. GRISWOLD, THE 5TH AMENDMENT TODAY 73 (1955), *noted in* Malloy v. Hogan, 378 U.S. 1, 9 n.7 (1964).

[66]*See* 8 J. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2251, at 295 n.1 (McNaughton rev. 1961).

[67]*See* Wilson v. United States, 149 U.S. 60 (1892).

[68]*See* MCCORMICK, *supra* note 64, § 118, at 252.

[69]*Id.*

[70]*See* Meltzer, *Required Records, The McCarran Act, and the Privilege Against Self-Incrimination*, 18 U. CHI. L. REV. 687, 692-93 (1951).

[71]*See* MCCORMICK, *supra* note 64, § 118, at 252.

[72]United States v. Grunewald, 233 F.2d 556, 591 (2d Cir. 1956) (Frank, J., dissenting), *rev'd*, 353 U.S. 391 (1957).

In sum, the criminal defendant privilege serves some important societal objectives: equalization of the criminal process, elimination of misleading appearances of guilt, and self-preservation. These societal objectives are naturally implicated without the need for an intricate weighing process in criminal actions, which are primarily punitive in nature. These objectives, however, are less forceful and perhaps even irrelevant in civil actions which accomplish goals other than punishing a defendant.[73] Consequently, the criminal defendant privilege has no theoretical basis for application in civil proceedings. Some actions, however, contain civil as well as criminal or penal elements. Attempts to classify these hybrid actions into civil and criminal categories for purposes of extending procedural safeguards such as the criminal defendant privilege overlook the underlying policies for applying the privilege.

Logic and consistency demand that courts analyze whether the policies of the criminal defendant privilege apply in certain gray areas. If a proceeding contains civil as well as criminal elements, then the courts should examine whether the policies for the privilege are implicated and, if so, whether they are outweighed by competing policies favoring a civil proceeding without such procedural safeguards.

The removal action, as the Texas Supreme Court noted in *Meyer*, possesses civil and criminal traits.[74] The action is civil in nature because it protects the public from corrupt and incompetent officials.[75] Even so, the action is also criminal in character because it strips an individual of his office as well as imposes a fine.[76] Because the action contains these divergent elements, the court should consider whether the policies for the criminal defendant privilege are involved and whether they outweigh any countervailing reasons for not extending the privilege.

At first blush, a removal proceeding does not implicate the policies behind the criminal defendant privilege. To be sure, the proceeding does not involve a prosecution and conviction in the ordinary sense. Moreover, not all persons are subject to removal proceedings. The action, however, is analogous to a criminal proceeding; in lieu of incarceration, a judgment of removal is entered with an accompanying fine.[77] Because of the defendant officer's stake in the outcome of the

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[73]*See, e.g.*, Meyer v. Tunks, 360 S.W.2d at 520 (court determined that removal action was civil in nature because of its primarily protective purpose).

[74]*Id. See also* text accompanying notes 62-63 *supra*.

[75]State v. Borstad, 27 N.D. at 537, 147 N.W. at 381; Meyer v. Tunks, 360 S.W.2d at 520. *See also* text accompanying notes 56 & 62 *supra*.

[76]*See* Meyer v. Tunks, 360 S.W.2d at 520. *See also* note 22 *supra* and accompanying text.

[77]*See* note 22 *supra* and accompanying text.

removal proceeding, the defendant's interest in self-preservation is seriously threatened. The officer will be confronted with the dilemma of telling the truth, thereby facing removal, or lying to protect himself, thereby committing perjury. In addition, the accused officer justifiably may be apprehensive about testifying. This apprehension may create the appearance of guilt. Moreover, the accused officer may be so intimidated that he will be unable to invoke the witness privilege. Such a result may relieve the prosecutor of the burden of establishing guilt. Clearly, the policies of self-preservation, elimination of misleading appearances of guilt, and equalization of the removal process are implicated and therefore justify the application of the criminal defendant privilege to a removal proceeding.

Because these policies are involved, consideration must be given to the competing policies weighing against the application of the criminal defendant privilege in removal proceedings. Indeed, *Borstad* and *Meyer* held that the privilege is not required in removal proceedings because of the public's interest in removing corrupt officials.[78] The Idaho Supreme Court in *Borstad* explicitly stated that procedural safeguards create technical obstacles which impede citizen efforts to remove incompetent and dishonest officers;[79] yet, elementary principles of due process and procedural fairness demand more consideration for the rights of an accused official in a removal proceeding. The "inequality" of process and the misleading appearance of guilt created by an official taking the stand, as well as the need to preserve individual integrity, are considerations that outweigh the public interest in streamlined procedures. The inconvenience of recognizing this procedural safeguard is an inadequate reason for erroneously destroying an otherwise innocent official's public career. In brief, the public interest in removing dishonest officials can be accomplished effectively without denying the officer an important privilege.

III. CONCLUSION

Quasi-penal, quasi-criminal, special, and statutory are just a few of the designations made by various courts confronted with the problem of characterizing a removal suit. Whether this wide divergence in treatment is due to the common law rule that misconduct in office constitutes a crime,[80] or to "some peculiar feature of the [removal] statute . . . not common to that of [other states],"[81] the

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[78]27 N.D. at 537, 147 N.W. at 381; 360 S.W.2d at 520.

[79]27 N.D. at 537-38, 147 N.W. at 381-82.

[80]*See* note 4 *supra* and accompanying text.

[81]State v. Medler, 17 N.M. 644, 647, 131 P. 976, 977 (1913).

cause is essentially immaterial to whether the criminal defendant privilege applies.

Although a removal proceeding affords a public rather than a private remedy, classifying the removal action as civil ignores the policies that may be violated if the criminal defendant privilege does not apply. Self-preservation, equalization of the removal process, and elimination of misleading appearances of guilt outweigh competing policies favoring a streamlined removal proceeding. Accordingly, the privilege should apply. The application of the criminal defendant privilege to a removal proceeding conforms with Justice Powell's view that some noncriminal and nonpecuniary sanctions deserve the same procedural safeguards which are accorded criminal matters.[82] Such a viewpoint recognizes that labels are a poor substitute for sound reasoning.[83]

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[82]*See* Argersinger v. Hamlin, 407 U.S. 25 (1972) (Powell, J., concurring). For instance, in the case of a drunken-driving or hit-and-run conviction, the punishment does not generally include imprisonment. Losing one's driver's license is the most common result. Depending on the individual's circumstances, the loss of a driver's license may be a more severe punishment than a brief incarceration. Consequently, a more sophisticated consideration of the policies underlying the additional safeguards afforded in criminal actions should be engaged in whenever "the deprivation of property rights and interests is of sufficient consequence." *See id.* at 48-49.

[83]One might argue that courts may weigh these policies differently, depending on the status or importance of one's office. Arguably, public interest in the removal of officers may vary according to an officer's position of trust. An officer holding an important office affecting public security or welfare may not warrant the same procedural safeguards because of the public's overwhelming interest in removing corrupt officials. Technical impediments, such as the criminal defendant privilege, may delay, if not shortcircuit, citizen efforts to remove incompetent and dishonest officials; yet, drawing a distinction on the basis of an individual officer's position is highly artificial. The position will be important to an accused official, regardless of its relative status or elevation in the governmental scheme. The stigma of being removed from office on any level implicates the policies favoring the extension of extra-procedural safeguards. In fact, the stigma may increase proportionally to the prestige and position of higher office. Thus, courts should weigh the policies in the same manner for any official, notwithstanding any difference in authority.

The Bankruptcy Code of 1978 and Its Effect Upon Tenancies by the Entireties

I. INTRODUCTION

The form of co-ownership known as tenancy by the entireties historically has created a number of problems in the area of bankruptcy, in large part due to conflicting underlying policies. A significant policy underlying the entireties estate is protection of the marital unit; to some extent, the estate enables a husband and wife to immunize their jointly held property from seizure by creditors. Bankruptcy, in contrast, "is a system of trade-offs seeking to draw a balance among conflicting interests. In exchange for a discharge of debts, the bankrupt surrenders his assets. . . . Inherent in the exchange is the attempt to maximize both equity to the creditors and rehabilitation of the debtor."[1] The policies underlying tenancy by the entireties and bankruptcy are in strongest conflict when the debtor's ability to immunize his property from seizure becomes unjust. Legislative and judicial measures designed to balance the competing interests have achieved varied results.

The Bankruptcy Reform Act of 1978,[2] which will hereinafter be referred to as the Code, became effective October 1, 1979. This Note will explore the effect of that statute upon the balancing of interests when tenancy by the entireties property is at issue. Because of the volume of material, the discussion will focus only upon the situation in which one spouse is in bankruptcy. Section 522(b)[3] serves as the point of departure. Careful analysis of this section raises questions on two levels. First, underlying theoretical problems will be considered. For example, one must determine, under section 541,[4] what items of property are included in the bankruptcy estate. Resolution of this problem requires an examination of the new Code's interest test to discover whether entireties property becomes a part of that estate. Another theoretical question is whether entireties property, if it does become a part of the bankruptcy estate, may be exempted under section 522. Second, the statutory language of section 522(b) will be considered. Thereafter, this Note will examine the interrelationship of these theoretical and interpretive issues. Finally, the

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[1]Comment, *Bankruptcy Exemptions: State Law or Federal Policy?* 35 U. PITT. L. REV. 630 (1974) [hereinafter cited as Comment].

[2]Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-151326 (Supp. II 1978)).

[3]11 U.S.C. § 522(b) (Supp. II 1978).

[4]*Id.* § 541.

foregoing analysis will be applied to the bankruptcy process in Indiana, both prior to and following enactment by the Indiana General Assembly of House Bill 1359.

II. BACKGROUND

An analysis of the effects of the Code upon entireties property must begin with section 522 of the Bankruptcy Reform Act of 1978.[5] This section deals with the exemptions which a debtor may claim upon bankruptcy and combines aspects of the Bankruptcy Act of 1898,[6] hereinafter referred to as the Act, with new ideas instituted by Congress and the authors of the new Code. The purpose of exemptions is rehabilitation—to enable the debtor to "make a fresh start in life and bear the burden of future responsibility."[7]

Section 522(b), the provision relevant to the subject matter of this Note, provides:

> (b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate either—
> (1) property that is specified under subsection (d) [the federal schedule of exemptions] of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
> (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and
> (B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant by the entirety or joint tenant to the extent that such interest as a tenant is exempt from process under applicable nonbankruptcy law.[8]

The section, as it relates to entireties property, creates both theoretical problems and questions of statutory interpretation.

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[5]*Id.* § 522.

[6]Bankruptcy Act of 1898, 11 U.S.C. §§ 1-1103 (1976) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549).

[7]Comment, *supra* note 1, at 630.

[8]11 U.S.C. § 522(b) (Supp. II 1978).

III. Legal Theory

In order to evaluate the theoretical problems presented by section 522(b), an understanding of that section's role in the bankruptcy process is necessary. In general, when a debtor takes bankruptcy, an estate is created into which pass the debtor's interests and property.[9] At a later point in the proceeding, the debtor, under section 522, may exempt limited amounts of property with which he may make a fresh start.[10] The assets and interests in the property remaining compose the net bankruptcy estate in which the creditors share. The debtor is eventually adjudicated bankrupt and discharged by the bankruptcy court from debts arising prior to the order for relief.[11]

A. Inclusion of Entireties Property Within the Bankruptcy Estate

Before an item of property or an interest therein can be exempted from the bankruptcy estate under section 522, it must be included within that estate. Therefore, consideration of section 541 is necessary to determine what property comes into the bankruptcy estate. Some analysts of section 541 argue that because both section 522—dealing with exemptions—and section 363[12]—dealing with the right of the trustee to use, sell, or lease property of the estate—refer expressly to tenancy by the entireties, entireties property is intended to be included within the bankruptcy estate. Others assert that this argument is merely "bootstrapping," insisting that unless entireties property is first determined to be a part of the estate, sections 522 and 363 do not apply.[13] Analysis of section 541 provides support for the latter view.

To understand how section 541 relates to the question of what property is included within the estate, one must recognize that this section of the Code differs conceptually from the corresponding provision of the Act—section 70a.[14] To some extent, the differences are

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[9]*Id.* § 541(a).

[10]*Id.* § 522.

[11]*See generally* 11 U.S.C. §§ 101-151326 (Supp. II 1978); D. Epstein, Debtor—Creditor Law (2d ed. 1980); 1 Bankr. Serv. (L. Ed.) § 1.1.

[12]11 U.S.C. § 363 (Supp. II 1978).

[13]The latter group also argues that if the Code intended entireties property to be part of the bankruptcy estate it would have specifically included entireties property within § 541. In 20 or more jurisdictions which recognize this estate, entireties real estate will often prove to be the largest single item of property owned by a husband and wife. Therefore, this group argues that the drafters did not intend to include this estate within the bankruptcy estate.

[14]11 U.S.C. § 110(a) (1976) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549).

related to variations in the degree to which these statutes depend upon nonbankruptcy law. Section 70a of the Act relied heavily upon "nonbankruptcy law, usually state law, to determine what property came into the estate."[15] The Act made no provision for determining whether the bankrupt possessed an interest in property or owed a debt; therefore, resolving the issue mandated reliance upon nonbankruptcy law.[16]

A second area requiring reliance upon nonbankruptcy law was a provision of section 70a which vested the trustee with the bankrupt's title to certain kinds of property,[17] "including rights of action, which prior to the filing of the petition he [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered."[18] The Act, however, failed to provide a method for determining "whether and how, prior to the petition, the debtor could have transferred his property or his creditor could have reached it."[19]

Although the Act thus prompted resort to nonbankruptcy law at two distinct levels, the cases under that statute dealt primarily with the second issue. Courts often assumed that an interest existed and proceeded to question whether the interest was transferable or leviable.[20] This assumption is understandable because the latter inquiry assumes the former; it is impossible to transfer or levy upon an interest if no interest exists. In any event, the central question under the Act was whether an interest was transferable or leviable.[21]

Section 541(a)(1) of the Code now creates an estate composed of "all legal and equitable interests of the debtor at the time of the commencement of the case."[22] Thus, although resort to nonbankruptcy

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[15]4 COLLIER ON BANKRUPTCY ¶ 541.02[1] (15th ed. L. King 1979) [hereinafter cited as COLLIER].

[16]*See* Wetteroff v. Grand, 453 F.2d 544, 546 (8th Cir. 1972); Dioguardi v. Curran, 35 F.2d 431, 432 (4th Cir. 1929); *In re* Boudreau, 350 F. Supp. 644, 645 (D. Conn. 1972). *Cf. In re* United Milk Prod. Co., 261 F. Supp. 766, 768 (N.D. Ill. 1966); *In re* Berry, 247 F. 700, 705 (E.D. Mich. 1917). In these cases, the courts stated that it was necessary to refer to state law to decide if an interest was transferable or leviable.

[17]4 COLLIER, *supra* note 15, ¶ 541.02[1].

[18]11 U.S.C. § 110(a)(5) (1976) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549).

[19]4 COLLIER, *supra* note 15, ¶ 541.02[1].

[20]*See* Textile Banking Co. v. Widener, 265 F.2d 446, 452-53 (4th Cir. 1959); *In re* Wallace, 22 F.2d 171, 171-72 (E.D. Wash. 1927); *In re* Berry, 247 F. 700, 705 (E.D. Mich. 1917); Foland v. Hoffman, 186 Md. 423, 427, 47 A.2d 62, 65 (1946); 4A COLLIER ON BANKRUPTCY ¶¶ 70.15[1], 70.17[7] (14th ed. J. Moore 1971) [hereinafter cited as COLLIER].

[21]4A COLLIER, *supra* note 20, ¶ 70.17[7].

[22]11 U.S.C. § 541(a)(1) (Supp. II 1978).

law to determine whether the debtor has an interest in property is still necessary, the second step under the Act, involving the determination whether that interest was transferable or leviable, has been omitted. Because all "legal and equitable" interests in property come into the bankruptcy estate, there is no longer a need for a test to determine which interests will be included within the estate and which will not. The test under the Code is simply whether an interest exists.[23]

The question then arises whether individual spouses own any interest in entireties property during their joint lives. Again, as was the case with the question whether entireties property is part of the bankruptcy estate, there is a difference of opinion. Some analysts argue that other sections of the Code and legislative history support the conclusion that all spouses own interests in entireties estates during their joint lives. They point to section 541(c)(1)(A),[24] which states that "an interest of the debtor in property becomes property of the estate under subsection (a)(1) [concerning legal and equitable interests], (a)(2) [concerning interests in community property], or (a)(5) [concerning interests which the debtor acquires within 180 days after filing a petition for bankruptcy] of this section notwithstanding *any provision* . . . that restricts or conditions transfer of such interest by the debtor."[25] Arguing that the legal theory underlying the entireties estate—that neither spouse may individually sever the estate or transfer its property[26]—constitutes a "provision that restricts or conditions transfer of such interest,"[27] these analysts contend that under section 541(c)(1)(A) restrictions on entireties property will not be given effect.[28]

This group of analysts also looks to the legislative history of the Code for support. The following statement appears in the Report of the Committee on the Judiciary on Bankruptcy Law Revision:[29]

> With respect to other co-ownership interests, such as tenancies by the entirety, joint tenancies, and tenancies in common, the bill does not invalidate the rights, but provides a method by which the estate may realize on the value of the

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[23]4 COLLIER, *supra* note 15, ¶ 541.02[1] at 541-12.

[24]11 U.S.C. § 541(c)(1)(A) (Supp. II 1978).

[25]*Id.* (emphasis added).

[26]*See* notes 43-44 *infra*, and accompanying text.

[27]11 U.S.C. § 541(c)(1)(A) (Supp. II 1978).

[28]The drafters' primary interest in removing the restrictions of forfeiture clauses in contracts contradicts the argument that § 541(c)(1)(A) prohibits a spouse from severing entireties property. 1 BANKR. SERV. (L. Ed.) § 1:21 at 29 (citing Trost & King, *Congress and Bankruptcy Reform Circa 1977*, 33 BUS. LAW. 489, 508-10 (1978)).

[29]H.R. REP. NO. 95-595, 95th Cong., 2d Sess. 1-549, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963-6435.

> debtor's interest in the property while protecting the other rights. The trustee is permitted to realize on the value of the propery by being permitted to sell it without obtaining the consent or a waiver of rights by the spouse of the debtor or the co-owner, as may be required for a complete sale under applicable State law. The other interest is protected under H.R. 8200 by giving the spouse a right of first refusal at a sale of the property, and by requiring the trustee to pay over to the spouse the value of the spouse's interest in the property if the trustee sells the property to someone other than the spouse.[30]

The argument is that because this statement refers to the "debtor's interest" and the "other interest," that is, the spouse's interest, the drafters obviously believed that the individual spouses had interests.

Closer scrutiny reveals that these analysts are once again "bootstrapping";[31] they seem to indicate that because the Code in section 541(c)(1)(A) and its drafters in the legislative history refer to individual spousal interests, those interests must in fact exist. As will be discussed in more detail later, this proposition is not entirely true. Not all states which recognize the entireties estate accept the concept of present interests in individual spouses.[32] Before assessing the effects of section 541(c)(1)(A) and the legislative history on entireties property, one must determine whether the spouses have individual interests.

The ultimate question is, what constitutes an interest in property. Neither the Code nor the Act provides an answer. Therefore, as stated earlier,[33] resort must be had to nonbankruptcy law—state law—to discover whether the debtor has an interest in property.[34]

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[30]*Id.* at 177, [1978] U.S. CODE CONG. & AD. NEWS at 6137-38 (footnotes omitted).

[31]These arguments resemble those involving the question whether entireties property is part of the bankruptcy estate. *See* text accompanying notes 12-13 *supra*. The determination whether entireties property is part of the bankruptcy estate depends upon whether individual spouses have interests in the entireties estate. If spouses have individual interests in entireties property, then those interests become part of the bankruptcy estate.

[32]*See* notes 57-66 *infra*, and accompanying text.

[33]*See* text accompanying note 15 *supra*.

[34]In jurisdictions recognizing the entireties estate, other arguments support the view that individual spouses do not *necessarily* have an interest in entireties property. For example, a frequently stated rule under the Code is that the bankruptcy estate will have the same but no greater rights in property than the debtor had. 124 CONG. REC. H11,096 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards); 4 COLLIER, *supra* note 15, ¶ 541.24; 1 BANKR. SERV. (L. Ed.) § 1:21 at 29 (1979); 2 BANKR. L. REP. (CCH) ¶ 9501 (1979). *See* 11 U.S.C. § 541(d) (Supp. II 1978). Applying this rule to the entireties estate, if a particular jurisdiction finds an interest in the debtor which he or she could

Additional problems surface with respect to the terminology of the Code's interest test. The nomenclature used by the courts in the past often proved to be contradictory. For example, even in a jurisdiction which did not find a transferable or leviable interest under the Act, a court in its opinion might indicate first in one sentence that an individual spouse had no interest in an entireties estate and later that "the debtor's interest" would be dealt with in a certain way.[35] A possible explanation for this conflict in terms may be found in the Act's emphasis upon whether the interest of the individual spouse was transferable or leviable rather than whether an interest existed. Nevertheless, this imprecision is a major source of confusion under the Code. Because these statements are mutually exclusive, one of them must either be false or capable of explanation in some other way; either the debtor has an interest in property or he does not.

The assertion that a single spouse has no interest in entireties property leaves little room for explanation. It is an affirmative declaration and must be either true or false as it stands. The statement that the debtor's interest may be dealt with in a certain way may, however, give rise to a logical explanation that can resolve the apparent conflicts. Certain concepts do not readily lend themselves to expression through the use of words, as is illustrated by the difficulty of trying to translate words or ideas from one language into another. With reference to entireties property, difficulty is encountered in describing exactly what property rights spouses possess in the entireties estate. It is submitted that as a result of this linguistic problem, courts have often used the term "interest" to represent two completely different ideas: (1) the concept of interest under the Code, meaning the separate individual interest of

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have claimed, then the trustee will have the same right. If, however, the debtor under the law of his or her state has no interest in the entireties property, the trustee also cannot acquire any interest. This situation indicates that the Code did not assume *necessarily* that a debtor in every jurisdiction had an interest in entireties property because this rule can be logically applied whether a particular jurisdiction finds an individual interest or not.

Another argument for the view that the Code did not assume that spouses in all jurisdictions owned interests in entireties property is that § 541 fails to specifically deal with the interests in entireties property, although the section refers to a broad variety of interests which are included in the bankruptcy estate. *See* 11 U.S.C. § 541 (Supp. II 1978). Although this argument obviously does not provide conclusive proof that entireties property was not intended to be part of the estate (in fact the possibility exists that § 541(c)(1)(A) was intended to cover entireties property), it may indicate an absence of any intent to include all entireties property within the bankruptcy estate.

[35]Chandler v. Cheney, 37 Ind. 391, 397 (1871); Sharpe v. Baker, 51 Ind. App. 547, 553-55, 96 N.E. 627, 629 (1911).

one spouse; and (2) the concept of a spouse's right to possess and enjoy entireties property.

The latter idea might be expressed more accurately as follows: the husband and wife own the entireties property as the marital unity and as individual spouses representing that unity, they are permitted to use and enjoy the property for their joint lives.[36] This explanation squares with the fact that individually the spouses have no interest, yet explains linguistically why they may separately use and enjoy the estate, its proceeds, rents, and profits.

B. Application of the Interest Test

Having considered the changes wrought by the Code, this Note will next assess the effect of those changes upon the estate of tenancy by the entireties. To evaluate the impact one must first understand the history and theory of the entireties estate.

1. History and Theory of Entireties.—Tenancy by the entireties is a peculiar and anomalous estate, sui generis.[37] In jurisdictions acknowledging the estate today as well as at common law, two essential characteristics distinguish it from other forms of coownership. First, entireties property is held or owned jointly by the husband and wife as the marital unity. This characteristic is based upon the fiction that the husband and wife in the marital unity constitute one legal person.[38] They are said to be seized of the estate *per my et non per tout.*[39] Many commentators have stated that this fictional attribute constitutes a fifth unity, in addition to those of time, interest, title and possession.[40] This characteristic, at least in part, distinguishes tenancy by the entireties from joint tenancy. The second distinguishing incident of the entireties estate is that of survivorship. Upon the death of either spouse, the survivor takes the whole by virtue of the original title; no new interest is created.[41]

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[36]*See* Huber, *Creditor's Rights in Tenancies by the Entireties*, 1 B.C. INDUS. & COM. L. REV. 197, 202 (1960).

[37]Koehring v. Bowman, 194 Ind. 433, 436, 142 N.E. 117, 118 (1924); 4 G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY § 1784, at 63 (repl. ed. 1979).

[38]2 AMERICAN LAW OF PROPERTY § 6.6, at 23 (A. J. Casner ed. 1952) [hereinafter cited as A.L.P.]; 4A R. POWELL, THE LAW OF REAL PROPERTY ¶ 620, at 683 (1979); 4 G. THOMPSON, *supra* note 37, § 1784, at 58; 2 H. TIFFANY, THE LAW OF REAL PROPERTY § 430, at 217 (3d ed. 1939).

[39]Sharpe v. Baker, 51 Ind. App. 547, 552, 96 N.E. 627, 628 (1911); 4 G. THOMPSON, *supra* note 37, § 1784, at 58-59.

[40]2 A.L.P., *supra* note 38, § 6.6, at 23-25; 4A R. POWELL, *supra* note 38, ¶ 620 at 683. Note, however, that "there is a modern tendency to disregard the necessity of existence of the four unities in creating a tenancy by the entireties." 4 G. THOMPSON, *supra* note 37, § 1785, at 73.

[41]Sharpe v. Baker, 51 Ind. App. at 553, 96 N.E. at 629; 4 G. THOMPSON, *supra* note 37, § 1784, at 70. A difference exists between the right of survivorship incident to

Other incidents of tenancy by the entireties which existed at common law remain today. For instance, the parties must be husband and wife when the estate is formed.[42] One tenant cannot unilaterally sever or partition the estate;[43] the entire estate may be transferred only by the joint action of both husband and wife.[44] Furthermore, in many jurisdictions a grant of realty to a husband and wife without further specification is presumed to create an estate by the entireties.[45]

Although a number of characteristics of the estate have not changed, many common law rules regarding tenancy by the entireties are no longer followed. For example, it is no longer true that the estate can be created by "purchase" only.[46] Moreover, in a majority of jurisdictions one spouse need no longer convey a separately owned piece of property to a "strawman" who then reconveys to the husband and wife as a unit; statutes in most states now allow "the estate to be created by one spouse conveying to both."[47]

It is important to remember that "[t]he right of husband and wife to acquire and hold property by the entireties is not an inherent right, but is a privilege which is subject to repeal, modification or limitation except as to rights already acquired."[48] Statutory changes have had a great impact upon the entireties estate, especially the married women's property acts, which enabled married women

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tenancy by the entireties and that incident to joint tenancy. In *Sharpe*, the court stated:

> The right of the survivor to take the whole estate is common, both to estates in joint tenancy and estates by entireties; but the right by which the survivor holds in each is not the same. If a joint tenant dies during the existence of the joint tenancy, his moiety goes to the survivor by *jus accrescendi*, or right of survivorship; but when a tenant by the entirety dies, the survivor holds the entire estate, not by virtue of any right which he acquires as survivor, but by virtue of the original grant or devise.

51 Ind. App. at 553, 96 N.E. at 629.

[42] 2 A.L.P., *supra* note 38, § 6.6, at 23; 4A R. POWELL, *supra* note 38, ¶ 622, at 690; 4 G. THOMPSON, *supra* note 37, § 1784, at 66; 2 H. TIFFANY, *supra* note 38, § 436.

[43] 4A R. POWELL, *supra* note 38, ¶ 623, at 700; 4 G. THOMPSON, *supra* note 37, § 1784, at 64; 2 H. TIFFANY, *supra* note 38, § 436.

[44] 4A R. POWELL, *supra* note 38, ¶ 623, at 700; 2 H. TIFFANY, *supra* note 38, § 436. These first two characteristics are based upon the fictional unity of husband and wife.

[45] 2 A.L.P., *supra* note 38, § 6.6, at 25; 4A R. POWELL, *supra* note 38, ¶ 622, at 686; 4 G. THOMPSON, *supra* note 37, § 1784, at 59-62. This last characteristic is not based upon the fictional unity of husband and wife.

[46] Craig, *An Analysis of Estates by the Entirety in Bankruptcy*, 48 AM. BANKR. L.J. 255, 257 (1974). *See* 4 G. THOMPSON, *supra* note 37, § 1784, at 66-67; 2 H. TIFFANY, *supra* note 38, § 431.

[47] Craig, *supra* note 46, at 257. *See* 4A R. POWELL, *supra* note 38, ¶ 622; 4 G. THOMPSON, *supra* note 37, § 1785, at 77-78. Indiana has enacted its own "strawman" statute. IND. CODE § 32-1-9-1 (1976).

[48] 2 H. TIFFANY, *supra* note 38, § 433, at 225-26.

to hold separate property.[49] Because of these statutes a number of jurisdictions by construction have abolished tenancy by the entireties. Other jurisdictions by judicial decision have abolished the estate for policy reasons.[50]

The rule at common law was that the husband and wife were one person, and that person was the husband.[51] The wife's disability created by coverture enabled the husband to use, possess, take the income from, and control all of the property of the marital unity during the joint lives of the spouses.[52] This right of enjoyment has often been referred to as the usufruct.[53] The right to the usufruct gave the husband the power to "convey or lease the land so as to give his conveyee an exclusive right to possession, subject only to such restrictions as are necessary to assure the wife full possession and enjoyment if she is the survivor of the couple."[54] If the husband survived his wife, his grantee acquired an absolute estate.[55]

The states have interpreted differently the effects of the married women's property acts upon the usufruct and the survivorship rights of tenancy by the entireties.[56] Massachusetts has adopted the

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[49]2 A.L.P., *supra* note 38, § 6.6d, at 31; 4A R. POWELL, *supra* note 38, ¶ 621; 2 H. TIFFANY, *supra* note 38, § 433, at 226-28. *See, e.g.*, Poulson v. Poulson, 145 Me. 15, 70 A.2d 868 (1950); Wilson v. Wilson, 43 Minn. 398, 45 N.W. 710 (1890); Clark v. Clark, 143 Mont. 183, 387 P.2d 907 (1963); Davis v. Davis, 223 S.C. 182, 75 S.E.2d 46 (1953).

[50]4A R. POWELL, *supra* note 38, ¶ 621; 2 H. TIFFANY, *supra* note 38, § 433, at 228. *See* Kerner v. McDonald, 60 Neb. 663, 84 N.W. 92 (1900).

[51]2 A.L.P., *supra* note 38, § 6.6, at 28.

[52]*Id.*; 4A R. POWELL, *supra* note 38, ¶ 623; 4 G. THOMPSON, *supra* note 37, § 1789, at 96.

A difference of opinion exists regarding the exact nature of the husband's interest in entireties property at common law. The Indiana Court of Appeals, in reviewing the development of the entireties estate, stated that at common law the husband had an "estate" in the usufruct during the joint lives of the spouses. Sharpe v. Baker, 51 Ind. App. at 553, 96 N.E. at 629. The court's analysis indicates that until the enactment of the married women's property statutes, courts held that there was no individual interest in either spouse. *See id.*

However, Professor Huber has argued that no individual interests existed at common law: "When this estate existed at common law, the husband exercised complete control not because he had an individual interest but because he represented the marital unity." Huber, *supra* note 36, at 202.

The right to the usufruct pertained to all jointly owned property as well as to that owned individually by either spouse. 4 G. THOMPSON, *supra* note 37, § 1789; 2 H. TIFFANY, *supra* note 38, § 435.

[53]*See* Sharpe v. Baker, 51 Ind. App. 547, 558, 96 N.E. 627, 630 (1911); Craig, *supra* note 46, at 257.

[54]4A R. POWELL, *supra* note 38, ¶ 623 (footnotes omitted); 2 A.L.P., *supra* note 38, § 6.6, at 28; 4 G. THOMPSON, *supra* note 37, § 1789, at 97-98; 2 H. TIFFANY, *supra* note 38, § 435.

[55]2 A.L.P., *supra* note 38, § 6.6, at 28; 2 H. TIFFANY, *supra* note 38, § 435.

[56]*See, e.g.*, Pray v. Stebbins, 141 Mass. 219, 4 N.E. 824 (1886); Kahn v. Kahn, 43 N.Y.2d 203, 371 N.E.2d 809, 401 N.Y.S.2d 47 (1977); Robinson v. Trousdale County, 516 S.W.2d. 626 (Tenn. 1974); Wambeke v. Hopkin, 372 P.2d 470 (Wyo. 1962).

position that these statutes have altered nothing.[57] Thus, as was the case at common law, the husband still holds the right to the usufruct, which he may transfer and upon which his creditors can levy.[58] He may also convey his contingent interest.[59] The wife, however, has no separate interest which she may transfer or upon which her creditors can levy.[60] Two jurisidictions have ruled that the usufruct is common to both spouses; neither has any interest which may be levied upon or transferred. Nevertheless, these jurisdictions hold that the husband and wife have individual interests in the right of survivorship, interests upon which creditors of the individual spouses can levy.[61] Other states have declared that the individual spouses have interests in the usufruct and right of survivorship which may be alienated or reached by creditors.[62] The majority position is that neither spouse has any interest which may be individually transferred or levied upon by creditors.[63] Finally, some jurisdictions fit into none of these categories.[64]

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[57]Krokyn v. Krokyn, 390 N.E.2d 733, 736 (Mass. 1979); Pray v. Stebbins, 141 Mass. 219, 221-23, 4 N.E. 824, 825-26 (1886); Huber, *supra* note 36, at 200; Plumb, *The Recommendations of the Commission on Bankruptcy Law—Exempt and Immune Property*, 61 VA. L. REV. 1, 115 (1975).

[58]Raptes v. Pappas, 259 Mass. 37, 38, 155 N.E. 787, 787 (1927). *See* Huber, *supra* note 36, at 200; Plumb, *supra* note 57, at 115.

[59]Raptes v. Pappas, 259 Mass. 37, 38, 155 N.E. 787, 787 (1927). *See* Huber, *supra* note 36, at 200; Plumb, *supra* note 57, at 115.

[60]Licker v. Gluskin, 265 Mass. 403, 406, 164 N.E. 613, 615 (1929); Huber, *supra* note 36, at 200; Plumb, *supra* note 57, at 115.

[61]These jurisdictions are Kentucky and Tennessee. *See, e.g.*, Campbell County Bd. of Educ. v. Boulevard Enterprises, Inc., 360 S.W.2d 744 (Ky. 1962); Robinson v. Trousdale County, 516 S.W.2d 626 (Tenn. 1974); Cole Mfg. Co. v. Collier, 95 Tenn. 115, 31 S.W. 1000 (1895). *See also* 4A R. POWELL, *supra* note 38, ¶ 623, at 702; Craig, *supra* note 46, at 302; Plumb, *supra* note 57, at 116.

[62]The states in this group are Alaska, Arkansas, New Jersey, New York, and Oregon. *See, e.g.*, Ellis v. Ashby, 227 Ark. 479, 299 S.W.2d 206 (1957); Moore v. Denson, 167 Ark. 134, 268 S.W. 609 (1924); Kahn v. Kahn, 43 N.Y.2d 203, 371 N.E.2d 809, 401 N.Y.S.2d 47 (1977); Hiles v. Fisher, 144 N.Y. 306, 39 N.E. 337 (1895). *See* 4A R. POWELL, *supra* note 38, ¶ 623, at 703; Craig, *supra* note 46, at 295-301; Plumb, *supra* note 57, at 117-18.

[63]The jurisdictions in this group include Delaware, the District of Columbia, Florida, Indiana, Missouri, Pennylvania, Rhode Island, Vermont, the Virgin Islands, Virginia, and Wyoming. *See, e.g.*, Johnson v. McCarty, 202 Va. 49, 115 S.E.2d 915 (1960); Allen v. Parkey, 154 Va. 739, 149 S.E. 615 (1929); Wambeke v. Hopkin, 372 P.2d 470 (Wyo. 1962); Peters v. Dona, 49 Wyo. 306, 54 P.2d 817 (1936). *See* 4A R. POWELL, *supra* note 38, ¶ 623, at 627 n.12; Craig, *supra* note 46, at 295-301.

[64]Oklahoma recognizes a form of tenancy by the entireties by statute rather than court decision. In Oklahoma, entireties property may be sold in order to pay the debts of either spouse. Such a sale destroys the right of survivorship, as in the case of a sale of jointly owned property. OKLA. STAT. tit. 60, § 74 (1971). *See* 4A R. POWELL, *supra* note 38, ¶ 623, at 705; Plumb, *supra* note 57, at 118.

Michigan recognizes that the husband has a transferable interest in the usufruct and the right of survivorship which creditors, however, can not attach. American State

2. Tenancy by the Entireties Property as Property of the Bankruptcy Estate.—Under the Code, the test for determining whether property will pass into the bankruptcy estate is whether the debtor has an interest in the property. Ultimately, this determination implicates state law. To the extent that such an interest is found to exist, the property will become part of the estate.

Theoretically, three possible results emanate from the juxtaposition of the Code and the Act:[65] (1) If there was a transferable or leviable interest under the Act, ipso facto the debtor had an interest. This interest, therefore, will pass into the bankruptcy estate under the Code. (2) If there was no transferable or leviable interest under the Act, either the debtor had no interest, in which case nothing will pass into the bankruptcy estate under the Code, or (3) the debtor had an interest which he could not transfer for some reason, in which case that interest will pass into the bankruptcy estate under the Code. An examination of the new interest test in the context of the three hypothetical situations may provide some insight into the impact of that standard upon the entireties estate.

In the first category, in which a transferable or leviable interest was identified under the Act, an interest arguably will be found under the Code. Therefore, in Massachusetts, the husband's interest in the usufruct and survivorship interest will pass into his bankruptcy estate. Those jurisdictions which identified a present transferable or leviable interest in the right of survivorship under the Act should allow that interest, be it husband's or wife's, to pass. In states identifying a present interest in both the usufruct and survivorship, either spouse's interest in such property presumably will pass into the estate. No change has occurred regarding the interests which pass in the first category. Because such interests were transferable and leviable under the Act, title to them passed to the trustee. Under the Code, both the usufruct and survivorship rights are interests and will therefore pass into the bankruptcy estate.

Similarly, there will be no change with respect to the interests which pass in the second category, that is, when no alienable or leviable interest was found under the Act because the debtor had no

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Trust Co. v. Rosenthal, 255 Mich. 157, 237 N.W. 534 (1931); Dickey v. Converse, 117 Mich. 449, 76 N.W. 80 (1898). *See* Plumb, *supra* note 57, at 117. *Cf.* Glazer v. Beer, 343 Mich. 495, 72 N.W.2d 141 (1955) (under special facts the court allowed creditors to reach the husband's interest).

North Carolina grants the husband a total interest in the income, but not the corpus, from property held with his wife as tenants by the entireties. Creditors can, however, attach this interest to satisfy the husband's debts. Lewis v. Pate, 212 N.C. 253, 193 S.E. 20 (1937); Johnson Produce v. Massengill, 23 N.C. App. 368, 208 S.E.2d 709 (1974). *See* Plumb, *supra* note 57, at 117.

[65]*See* text accompanying notes 12-36 *supra*.

interest. If no individual interest existed which could be tranferred or levied upon under the Act, none will be present under the Code.

Only in the final category will the Code produce a different result. When the debtor had an interest which was neither transferable nor leviable under the Act, the interest will pass into the bankruptcy estate under the Code's test. Michigan serves as an example.[66] There, the husband holds the usufruct during the joint lives of the spouses. He can also convey both the usufruct and his contingent remainder. Under the Act, however, creditors could not reach either of these interests to satisfy individual debts of the husband.[67] According to one author, the reason for this rule was that access by creditors would encroach upon the wife's and family's possibility of benefiting from these interests.[68] This result will change under the Code's interest test. It is apparent that the husband has an interest since he could transfer that interest under the Act. Because the state's determination whether an interest is transferable or leviable is no longer relevant under the Code, the interest of the husband will pass into his bankruptcy estate.

Thus, the new test utilized by the Code will not in most instances result in the inclusion of different interests and property within the bankruptcy estate. Changes will occur only in those jurisdictions in which an interest existed which was not transferable or leviable under the Act.

C. Exemption of Entireties Property

Another theoretical question which arises under the Code is whether tenancy by the entireties property qualifies as an exemption under section 522. The statute neither defines the term "exemption" nor indicates a legislative intent to exempt all entireties property. Similarly, the Act made no attempt either to define the word "exemption" or to limit the range of exempt property.

Commentators and courts generally agreed that entireties property was not exempt under the Act.[69] One court has stated that the protection which the Act afforded tenancy by the entireties property was not based upon its status as exempt property, but instead

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[66]*See* American State Trust Co. v. Rosenthal, 255 Mich. 157, 237 N.W. 534 (1931); Dickey v. Converse, 117 Mich. 449, 76 N.W. 80 (1898).

[67]American State Trust Co. v. Rosenthal, 255 Mich. 157, 237 N.W. 534 (1931); Dickey v. Converse, 117 Mich. 449, 76 N.W. 80 (1898). *See* Plumb, *supra* note 57, at 117. *Cf.* Glazer v. Beer, 343 Mich. 495, 72 N.W.2d 141 (1955) (under special facts the court allowed creditors to reach the husband's interest).

[68]Plumb, *supra* note 57, at 117.

[69]*See, e.g.*, Shaw v. United States, 94 F. Supp. 245 (W.D. Mich. 1939); Comment, *supra* note 1; Plumb, *supra* note 57.

arose "from the peculiar nature of the estate."[70] In addition, authors often referred to entireties property as being "functionally exempt"[71] or "immune"[72] from seizure, thereby distinguishing it from exempt property.

Further proof that entireties property was not exempt under the Act lies in the different treatment given to exempt and entireties property by the rules dealing with conversion of nonexempt property. The general rule was, and still is, that a debtor may convert his nonexempt property into exempt property without committing a fraud upon his creditors,[73] thereby availing himself of any and all protections which the exemption statutes provide.[74] For example, under the Code, if a debtor does not own an automobile, he may sell his nonexempt assets and use the proceeds from those sales to purchase a car. He may then exempt the value of the car to the extent of $1200 under section 522(d)(2).[75]

The rule does not apply to entireties property. Thus, a debtor could not avoid the claims of his creditors by converting nonexempt assets into entireties property.[76] The courts generally have held that such an action constitutes a fraud upon the creditors and have set aside the conversion.[77] For a particular kind of property to qualify as exempt under the Act, it apparently had to be included within a specific schedule of property not subject to the trustee's claim. Because the schedules did not include entireties property, it was not

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[70]Shaw v. United States, 94 F. Supp. 245, 246 (W.D. Mich. 1939).

[71]Comment, *supra* note 1, at 631.

[72]Plumb, *supra* note 57, at 114.

[73]Bank of Pa. v. Adlman (*In re* Adlman), 541 F.2d 999, 1004 (2d Cir. 1976); Grover v. Jackson (*In re* Jackson), 472 F.2d 589 (9th Cir. 1973). *See* S. REP. No. 95-989, 95th Cong., 2d Sess. 76 (1978).

[74]Although the general rule still governs, the views upon this issue diverge. It is stated in *Collier* that under the Act, "the mere conversion of non-exempt property into exempt property on the eve of bankruptcy was not in itself such fraud as will deprive the bankrupt of his right to exemptions." 3 COLLIER, *supra* note 15, ¶ 522.08(4). Nevertheless, some authorities have adopted the view that if a fraudulent intent can be shown, then the exemption may be denied. *See id.* Determination of fraudulent intent depends upon the facts in each case. *Id. Collier* concluded that the new Code has adopted the view that "conversion of property into exempt property without more, will not be treated as fraudulent." *Id.*

[75]11 U.S.C. § 522(d)(2) (Supp. II 1978). The Indiana exemption statute does not have a specific exemption for an automobile; however, it does allow an exemption of $2000 worth of real or tangible personal property in addition to the personal or family residence. IND. CODE § 34-2-28-1(b) (Supp. 1979). House Bill 1359 has increased the limit on this exemption to $4000. *See* H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1).

[76]Craig, *supra* note 46, at 273-74, Annot., 7 A.L.R.2d 1104 (1949).

[77]*See, e.g., In re* Moore, 11 F.2d 62 (4th Cir. 1926); Cross v. Wagenmaker, 329 Mich. 100, 44 N.W.2d 888 (1950).

exempt.[78] Nevertheless, because it was "immune" or "functionally exempt" from creditor's claims, entireties property comprised a separate and distinct category.[79]

The intent of the drafters of the Code respecting exemption of entireties property is not clear. Although the Code does not expressly change the policy of the Act with respect to tenancy by the entireties property, section 522(b) may be interpreted so as to render entireties property exempt. The Act and state exemption provisions failed to deal with this estate,[80] but the Code's exemption provisions, in section 522, specifically refer to tenancies by the entireties.[81] Section 522(b)(2)(B) creates further confusion by providing that entireties is exempt "to the extent that such interest as a tenant by the entirety . . . is *exempt* from process under applicable nonbankruptcy law."[82] The rule in all jurisdictions prior to the enactment of the Code was that entireties property was not exempt, but fell within a category of its own. Thus, unless the states now make entireties property exempt, it seems this provision will be one of form without substance.[83]

IV. Statutory Interpretation

Another problem created by section 522(b) arises in connection with statutory interpretation. Section 522(b) of the Code appears unambiguous. Theoretically the Code establishes an exemption system which allows the debtor to choose either federal exemptions[84] or state

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[78]*See, e.g.*, Ind. Code § 34-2-28-1 (Supp. 1979); *see* Comment, *supra* note 1, at 631.

[79]*See, e.g.*, Ind. Code § 34-2-28-1 (Supp. 1979); *see* Comment, *supra* note 1, at 631.

[80]*See* 11 U.S.C. § 24 (1976) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549); Ind. Code § 34-2-28-1 (Supp. 1979). *But see* H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at Ind. Code §§ 34-2-28-0.5, -1).

[81]11 U.S.C. § 522(b)(2)(B) (Supp. II 1978).

[82]*Id.*

[83]If Indiana has made tenancy by the entireties property both a part of the bankruptcy estate and an exemption, it may have accomplished what the Code refers to in § 522(b)(2)(B).

[84]11 U.S.C. § 522(d) (Supp. II 1978). This is a new provision. The Act had no federal exemptions; only state exemptions existed. An earlier bankruptcy statute, the Bankruptcy Act of 1867, however, did include specific exemptions. Bankruptcy Act of 1867, ch. 176, §§ 1-50, 14 Stat. 517 (1867) (current version codified at 11 U.S.C. §§ 101-151326 (Supp. II 1978)). The 1867 Act and the new Code also possess the similarity of permitting the debtor to opt for more advantageous state exemptions. *See* 3 Collier, *supra* note 15, ¶ 522.02.

Note, § 522(b)(1) allows the individual states to "opt out" by requiring debtors to use the state schedule of exemptions. Although the language of this section is somewhat vague, the legislative history indicates that the choice of "opting out" can only be exercised by a specific prohibition of the option by the state. 3 Collier, *supra*

exemptions,[85] including the state's treatment of tenancy by the entireties property.[86] The general interpretation of section 522 is that the debtor's election to use either state or federal exemptions is exclusive. In other words, if the debtor chooses the federal exemptions, he is precluded from using the state schedule of exemptions and the state treatment of entireties property. Such an interpretation, however, is not the only possibility. One may argue that the state's treatment of tenancy by the entireties property does not apply solely under the state exemption option, but also may be used with the federal exemptions. This interpretation is nonexclusive. Support exists for both arguments.[87]

Those who maintain that an exclusive construction should control assert that gramatically the phrase, "either— . . . ; or, in the alternative . . . ," is disjunctive and the choices therefore are mutually exclusive.[88] Code commentators generally agree with this analysis.[89] One commentator has stated that "section 522(b)(2)(B) allows an exemption in the debtor's interest in property as a tenant by the entirety or joint tenant *if* the debtor chooses the state exemptions."[90] Another author, Professor Kennedy, who helped draft the Code,

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note 15, ¶ 522.02 (referring to 124 CONG. REC. H11,115 (daily ed. Sept. 28, 1978); S17, 412 (daily ed. Oct. 6, 1978)). The Indiana Legislature has recently chosen to exercise the option of disallowing the use of the federal exemptions. *See* H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE § 34-2-28-0.5).

[85]*See, e.g.*, IND. CODE § 34-2-28-1 (Supp. 1979) (Indiana exemption statute).

[86]11 U.S.C. § 522(b)(2)(B) (Supp. II 1978). This Code section also deals with property held in joint tenancy by the debtor and another.

[87]The resolution of this problem will be significant in a number of bankruptcy filings. For example, if an exclusive interpretation is adopted and the debtor has a large amount of entireties property, he may have a difficult choice of determining whether to use the federal exemptions—which in general tend to be more lenient than their state counterparts—and give up his or her entireties protection or to protect the entireties property and lose the advantages of the federal exemptions under § 522(d). Kennedy, *New Bankruptcy Act Impact on Consumer Credit*, 33 BUSINESS LAWYER 1059, 1064 (1978).

[88]As a general rule of construction, "[g]uidance may be drawn from consideration of principles of composition which may be supposed to apply to legislative drafting as well as other forms of writing." 2A A. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION, § 47.01 (4th ed. C. Sands 1978). *See* Allstate Mortgage Corp. v. Strasser, 277 So.2d 843 (Fla. 1973); Skinner v. State, 16 Md. App. 116, 293 A.2d 828 (1972).

After gramatically analyzing § 522, an English professor also concluded that the language was disjunctive. She maintained that this analysis was correct, regardless of the construction given the word "or." She based her conclusion on the definition of the word "alternative," as used in the statute, as "mutually exclusive." She said the punctuation indicated no other construction. Interview with Phyllis Scherle, Assistant Professor of English, Indiana University—Purdue University—Indianapolis, in Indianapolis (Jan. 7, 1980).

[89]*See, e.g.*, 3 COLLIER, *supra* note 15, ¶ 522.10; Kennedy, *supra* note 83, at 1064.

[90]3 COLLIER, *supra* note 15, ¶ 522.10 (emphasis added).

commented that "if one opts for the federal exemption, he will give up any advantage under state law that protects an estate by the entirety from invasion by creditors of either spouse. If you take the federal exemption, you submit to a termination of the estate by entirety."[91]

Those who argue for a nonexclusive interpretation assert that the language of section 522(b) should not be construed in a preclusive manner. The word "or" which is used in the clause creating the option is, according to section 102(5), not exclusive.[92] Thus, they submit that the options are not absolutely alternative.[93] The response to this argument is that the phrase "in the alternative,"[94] which follows the "or," is sufficient to negate the general rule of construction found in section 102(5). Further support for a nonexclusive interpretation is found in the analyses of section 522 by other commentators. One author has interpreted this section to allow the debtor to exempt his entireties or joint tenancy property regardless of his choice of the state or federal exemption schedules.[95]

Although little legislative history exists on this construction problem, some legislative reports and proposals support the nonexclusive construction.[96] The Senate version of this legislation employed a nonexclusive interpretation of section 522(b).[97] However,

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[91]Kennedy, *supra* note 87, at 1064. Kennedy made this statement in reference to the House version of the Code. His remarks are particularly pertinent because Congress adopted the House version of § 522.

[92]11 U.S.C. § 102(5) (Supp. II 1978).

[93]This argument is weakened because no one has argued yet that a debtor may use both the state and federal exemptions and choose between their specific provisions. If § 522(b)(1) and § 522(b)(2) are not exclusive on the entireties issue, then neither should be exclusive on the choice of specific exemptions.

[94]The Code does not define this phrase. The *American Heritage Dictionary* defines the word "alternative" as "[t]he choice between two mutually exclusive possibilities." THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 39 (1969).

[95]R. Roseburg, *The Bankruptcy Reform Act of 1978: An Overview*, in THE BANKRUPTCY REFORM ACT FOR BANK COUNSEL 9, 29-31 (1979).

[96]One must be aware that

> [t]he extent to which legislative history should be consulted is unclear. There are canons of statutory construction that the legislative history is never consulted when the statute is clear and unambiguous. On the other hand, some cases hold that it is always appropriate to consult legislative history to interpret a statute however clear the words of the statute may appear.

2 App. COLLIER, *supra* note 15, XXV n.129 (citing Train v. Colorado P.I.R.G., 426 U.S. 1, 10 (1976)).

[97]That section provides:

> (b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate:
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> (1) any property that is exempt under Federal, State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of

the House provision,[98] with some modifications of the amount of the exemptions, was eventually adopted. Legislative history, nevertheless, offers no clue about whether the adopted version of section 522 was based upon, or even took into consideration, the problem of statutory interpretation. The use of a conference committee to resolve the conflicts between these two statutes was impractical in this case because of the brief period of time before the end of the legislative session; thus, the differences in the House and Senate versions were reconciled without a public conference. The managers of the legislation worked out the differences.[99] The only published comment on the resolution of the conflicts is a statement by the House version sponsor, Congressman Edwards, and he did not discuss the problem of interpretation.[100]

Based upon the limited discussion of this issue in the legislative history, particularly with respect to the resolution of the conflicts between the House and Senate versions, it is possible that this interpretive question was not debated in Congress. The possibility exists that the members of Congress, at least the senators, not only had no intent to establish an exclusive provision but also had no knowledge of the effects of their actions.

V. Impact of Legal Theory upon Statutory Interpretation

Having examined both the theoretical and interpretive problems created by section 522, the effect of those two issues upon each other must be considered. In the final analysis, the theoretical issues

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the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(2) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant would have been exempt from process under applicable nonbankruptcy law.

S. 2266, 95th Cong., 2d Sess. § 522(b) (1978).

[98]H.R. 8200, 95th Cong., 1st Sess. § 522(b) (1978).

[99]2 App. Collier, *supra* note 15, at xxi (citing 124 Cong. Rec. H11,089 (daily ed. Sept. 28, 1978 (remarks of Rep. Edwards)).

[100]Congressman Edwards commented on this section:

> Section 522 of the House amendment represents a compromise on the issue of exemptions between the position taken in the House bill, and that taken in the Senate amendment. Dollar amounts specified in section 522(d) of the House bill have been reduced from amounts as contained in H.R. 8200 as passed by the House. The States may, by passing a law, determine whether the Federal exemptions will apply as an alternative to State exemptions in bankruptcy cases.

124 Cong. Rec. H11,095 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards).

have an important impact upon the interpretive issues; the latter being relevant only to the extent that an interest in entireties property exists within the bankruptcy estate.

An illustration at this point may be of some value. Assume that a husband and wife have assets consisting of real estate, which they use as their residence and own as tenants by the entireties, and a large amount of personal property. Assume also that the husband is now taking bankruptcy. Under the interpretive analysis of section 522(b), the question arises whether the husband should claim the federal or state exemptions. An exclusive interpretation of section 522(b) indicates that if he takes the federal exemptions he is precluded from using the state's exemptions and treatment of entireties property. A nonexclusive construction allows him to use the federal schedule and the state's treatment of entireties. In most cases, the latter choice would prove to be the most beneficial option for the debtor,[101] at least with respect to the value of the property exemptible. Nevertheless, the majority apparently accepts the exclusive interpretation of the election under the statute.[102] Therefore, the debtor ostensibly must choose whether to protect more of his personalty by electing the federal exemptions, thereby giving up the state protection of entireties property, or protect his realty by taking the exemptions provided by the state.

This analysis may be misleading, however, because it fails to consider that only the debtor's individual interest in the entireties property can be included within his bankrupt estate. In fact, depending upon the jurisdiction in which the debtor lives, the possibility exists that no part of the entireties estate may be subject to process. If the debtor lives in a jurisdiction which recognizes no present interest in an individual spouse who owns property by the entireties, the value of that entireties property should be zero.[103] In a jurisdiction following this rule, entireties property is owned by the marital unit and the debtor has no individual interest which can pass into the bankruptcy estate. The debtor under these facts may use the more advantageous federal schedule of exemptions and yet suffer no loss of the entireties property.[104]

Even in a jurisdiction which recognizes an interest in the individual spouse, the effect may be slight if the estate is not too

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[101]In jurisdictions permitting exemptions more lenient than those provided by the federal schedule, the debtor should elect to use the state schedule. *See* 11 U.S.C. § 522(b)(2) (Supp. II 1978).

[102]*See* text accompanying notes 84-100 *supra.*

[103]The debtor, however, should report the property in his list of assets to avoid any claim of concealment.

[104]This conclusion depends upon the assumption that the state in which the debtor lives has not chosen to preclude the use of the federal exemptions.

large. The contingent remainder and usufruct are often of uncertain value; thus, those interests may be of little value to the trustee. One commentator has stated:

> The value to the bankrupt estate of the interest which the trustee receives will depend on whether it is the usufruct or the contingent right of survivorship, or both; if the usufruct, whether it is one-half or the whole; and what the life expectancies of the spouses are. The marketability of the interest may be so limited that it must be abandoned by the trustee.[105]

If in fact the value of such an interest is minimal, the debtor, should he elect the federal exemption, can also exempt the value of that interest, up to the amount of $7,500, as provided by the personal residence exemption of section 522(d)(1).[106] Therefore, unless the value of the debtor's interest in the entireties property is fairly large, the estate will acquire nothing from its inclusion.

Ultimately these questions will be decided by the courts. Nevertheless, it seems that even though the Code seeks to bring more property or interests of the debtor into the estate than the Act, it has done little in fact to subject entireties property to the claims of creditors.

VI. Tenancy by the Entireties in Indiana

The state of bankruptcy law in Indiana as it relates to tenancy by the entireties property is uncertain with the passage of House Bill 1359[107] in early 1980. This bill represents a choice by the state to "opt out" of the federal exemptions of section 522(d) and thus allows a debtor in this state to use only the exemptions provided by the state schedule.[108] House Bill 1359 also makes a number of very

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[105]Craig, *supra* note 46, at 263.

[106]11 U.S.C. § 522(d)(1) (Supp. II 1978). This section provides:

> (d) The following property may be exempted under subsection (b)(1) of this section:
>
> (1) The debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtoror a dependent of the debtor.

Id. A debtor can exempt his personal residence to the extent of $5,000 under the old Indiana exemption statute. Ind. Code § 34-2-28-1(a) (Supp. 1979). Note, the amount of this exemption has now been increased to $7,500. H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at Ind. Code §§ 34-2-28-0.5, -1).

[107]H.B. 1359, 101st Ind. Gen. Ass., 2nd Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at Ind. Code §§ 34-2-28-0.5, -1).

[108]*See id.*

significant changes with regard to the exemptions provided by the current Indiana exemption statute.[109] These changes have created a number of problems which will be dealt with later. At this point, however, an analysis of the probable effects of the Code upon Indiana's treatment of entireties prior to the enactment of House Bill 1359 will serve as an example of the general impact of the statute upon the bankruptcy process.

A. Impact of the Code Prior to House Bill 1359

The bankruptcy courts' treatment of entireties property, applying Indiana law under the Act, provides no guidance in determining whether an interest in entireties will be found under the Code.[110] The rule those courts applied under the Act was that neither spouse had any interest in the usufruct or right of suriviorship that was transferable or leviable.[111] The result under the Code's interest test cannot be ascertained because the prior rule does not explain whether the lack of any transferable or leviable interest can be justified on the grounds that no interests existed or that, assuming the existence of interests, they were not leviable or transferable. Therefore, one must refer to the common law under the Act.

1. Interests in Entireties Property.—Spouses can hold only certain present individual interests in entireties property; this Note has already considered the usufruct and right of survivorship.[112] Yet, one might also argue that a creditor of one spouse owns or holds an interest in entireties property based upon an estoppel theory. Finally, arguments for the presence of individual interests might be based upon consideration of such areas as divorce, murder of one spouse by the other, or insanity of a spouse. In these three situations, bankruptcy courts applying Indiana law have held that the spouses own one-half interests in the entireties property.

Indiana law recognizes no present individual interest in tenancy by the entireties property in either spouse.[113] The Indiana Supreme Court, in an 1871 decision[114] dealing with the issue whether a husband had any mortgageable interest in entireties property, ruled that

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[109]*See* IND. CODE § 34-2-28-1 (Supp. 1979).

[110]*See also* section III. B. 2. of this Note.

[111]*See* Pension Fund v. Gulley, 226 Ind. 415, 81 N.E.2d 676 (1948); Baker v. Cailor, 206 Ind. 440, 196 N.E. 769 (1933); Chandler v. Cheney, 37 Ind. 391 (1871); Sharpe v. Baker, 51 Ind. App. 547, 96 N.E. 627 (1911).

[112]*See* text accompanying notes 51-55 *supra*.

[113]*See, e.g.*, Thornburg v. Wiggins, 135 Ind. 178, 34 N.E. 999 (1893); Chandler v. Cheney, 37 Ind. 391 (1871); Davis v. Clark, 26 Ind. 424 (1866).

[114]Chandler v. Cheney, 37 Ind. 391 (1871).

> at common law, . . . if a conveyance of land be made to a man and woman, who are then husband and wife, they take as joint tenants by entireties, not by moieties; they are seized *per tout*, and not *per my*. Each, as well as both, is entitled to the use of the whole. Neither can sever the joint estate by his own act. . . . Nor, it would seem, could the separate interest of either be sold on execution. *Indeed, there is no separate interest.*[115]

Moreoever, the court in *Thornburg v. Wiggins*,[116] stated: "The statutes extending the rights of married women have no effect whatever upon estates by entirety. Such estate is, in no sense, either the husband's or the wife's separate property."[117] A recent court of appeals case, *Yarde v. Yarde*,[118] reiterated the rule, observing that "the rule in Indiana is well established that neither the husband nor wife have a separate interest in real estate held by the entirety.[119]

Some cases make specific references to elements of the usufruct or right of survivorship.[120] The Indiana Court of Appeals in *Sharpe v. Baker*[121] considered the usufruct and held that "the possession and proceeds of such estates cannot be sold on execution for the individual debt of either the husband or wife; not because they are exempt by statute, but because neither has any separate interest therein."[122] In *Davis v. Clark*[123] the court dealt with the right of survivorship. In that case, the appellant argued that the husband had a contingent remainder in the land which was subject to execution because of the right of survivorship. The court stated that "[t]he right of survivorship, we think, did not constitute a remainder, either contingent or vested, in the legal sense of that term. . . . [T]he right of survivorship is simply an incident of an estate granted to husband and wife and does not constitute a remainder."[124]

The question then arises whether a present interest can be created by estoppel. The courts of Indiana have held that if a single spouse secures a loan with a warranty mortgage on entireties prop-

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[115]*Id.* at 397 (quoting Bevins v. Cline's Adm'r, 21 Ind. 37 (1863) (citations omitted)) (emphasis added).

[116]135 Ind. 178, 34 N.E. 999 (1893).

[117]*Id.* at 183, 34 N.E. at 1000.

[118]117 Ind. App. 277, 71 N.E.2d 625 (1946).

[119]*Id.* at 278, 71 N.E.2d at 625. *Accord*, Pension Fund of Disciples of Christ v. Gulley, 226 Ind. 415, 81 N.E.2d 676 (1948).

[120]*See, e.g.*, Davis v. Clark, 26 Ind. 424 (1866); Sharpe v. Baker, 51 Ind. App. 547, 96 N.E. 627 (1911).

[121]51 Ind. App. 547, 96 N.E. 627 (1911).

[122]*Id.* at 558, 96 N.E. at 630.

[123]26 Ind. 424 (1866).

[124]*Id.* at 430.

erty and later acquires the full title to that property, the title will inure "to the benefit of the mortgagee."[125] The mortgagor is estopped from contesting a foreclosure.[126] Estoppel, however, is merely an equitable device whereby the transferor is estopped to deny the validity of the mortgage after he has benefitted from the consideration conferred by the mortgagee; it does not create an interest.[127]

Indiana courts may also find an individual interest in entireties property in situations such as divorce, murder of one spouse by the other, and insanity of a spouse. In such situations, Indiana courts have ruled that spouses holding property by the entireties shall divide the estate, each taking a one-half share.[128] These circumstances may provide evidence that individual spouses own interests in entireties property; however, closer scrutiny reveals that this is not the case.

Cases involving divorce clarify the nature of interests in entireties property. The court of appeals in *Gibble v. Gibble* [129] ruled that "an absolute divorce terminates an estate by entireties and converts it into an estate as tenants in common."[130] Only after the entireties estate has terminated do the spouses become tenants in common, and until the termination of marriage has occurred, courts make no reference to individual interests.[131] The fact that individual interests are created upon the destruction of the entireties estate provides no indication that interests existed prior to the dissolution of the marriage. Thus, divorce cases offer no evidence of an interest in tenancy by the entireties property in the individual spouses.

Courts have applied similar arguments to situations involving murder of one spouse by the other and insanity of a spouse. Arguing by analogy, they have reached the same result as with divorce—destruction of the entireties estate and creation of one-half interests in each spouse.[132] A specific Indiana statute deals with the murder of

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[125]*E.g.*, Thalls v. Smith, 139 Ind. 496, 39 N.E. 154 (1894); Boone v. Armstrong, 87 Ind. 168 (1882).

[126]Thalls v. Smith, 139 Ind. 496, 39 N.E. 154 (1894).

[127]*See id.*; Boone v. Armstrong, 87 Ind. 168 (1882); Pancoast v. Travelers Ins. Co., 79 Ind. 172 (1881). *But see* Pension Fund of Disciples of Christ v. Gulley, 226 Ind. 415, 81 N.E.2d 676 (1948).

[128]*See, e.g.*, National City Bank of Evansville v. Bledsoe, 237 Ind. 130, 144 N.E.2d 710 (1957); Gibble v. Gibble, 111 Ind. App. 60, 40 N.E.2d 347 (1942). *See* IND. CODE § 32-4-4-1 (1976).

[129]111 Ind. App. 60, 40 N.E.2d 347 (1942).

[130]*Id.* at 61, 40 N.E.2d at 347. *Accord*, Maitlen v. Barley, 174 Ind. 620, 621, 92 N.E. 738, 738 (1910); Blake v. Hosford, 387 N.E.2d 1335, 1341-42 (Ind. Ct. App. 1979); Smith v. Smith, 131 Ind. App. 38, 52, 169 N.E.2d 130, 137 (1960). *See also* IND. CODE § 32-4-2-2 (1976).

[131]*See* Gibble v. Gibble, 111 Ind. App. 60, 40 N.E.2d 347 (1942).

[132]*See* National City Bank of Evansville v. Bledsoe, 237 Ind. 130, 144 N.E.2d 710 (1957); IND. CODE § 32-4-4-1 (1976).

an intestate, including a spouse.[133] Under this statute the rule requires that the murderer become a constructive trustee for those, other than himself who are entitled to a share under the law of intestate succession or a will.[134] In *National City Bank of Evansville v. Bledsoe*,[135] however, the court applied common law principles because the statute was inapplicable. The statute requires that the murdering spouse be convicted of homicide. In *Bledsoe*, the husband killed his wife and then committed suicide, thereby preventing his conviction. After recognizing that no Indiana cases treated the issue, the court adopted the view that a constructive trust should be imposed upon any share of the entireties estate passing to the husband.

The court also discussed the extent to which the constructive trust should be imposed. The court declared:

> [W]here the operation of a tenancy by entireties has been thwarted by a divorce or otherwise, the common law of the state divides the property equally between the original owners. There is no reason why the same division should not be made where a tenancy by entireties is dissolved by murder.[136]

The estate was thus destroyed and the wife's personal representative acquired a one-half interest in the entireties property. The one-half interest of the husband passed to his personal representative who then held it in constructive trust for the wife's heirs at law and legatees under her will.[137]

In reference to the insanity of a spouse, the rule is that the entireties estate is dissolved and a tenancy in common is produced, thereby creating one-half interests in the individual spouses. An Indiana statute provides:

> Whenever a husband and wife shall own and hold any real estate as joint tenants or tenants by entireties, and one of

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[133]IND. CODE § 29-1-2-12 (Supp. 1979).

[134]The statute provides:

> A person who is convicted of murder, . . . shall, in accordance with the rules of equity, become a constructive trustee of any property acquired by him from the decendent or his estate because of the offense, for the sole use and benefit of those persons legally entitled thereto other than such guilty person, saving to all innocent purchasers for value of interests therein acquired in good faith. Such conviction shall be conclusive in any subsequent suit to charge him as such constructive trustee.

Id.

[135]237 Ind. 130, 144 N.E.2d 710 (1957).

[136]*Id.* at 140, 144 N.E.2d at 714-15 (citation omitted).

[137]*Id.*, 144 N.E.2d at 715.

> them shall have been adjudged a person of unsound mind, by a court of competent jurisdiction, and when said insanity is probably permanent, they shall cease to hold and own said real estate as joint tenants or tenants by entireties, as the case may be, but the title to said real estate shall be owned and held by them as tenants in common.[138]

In all three of the above situations—divorce, murder of one spouse by the other, and insanity of a spouse—Indiana courts have held that the entireties estate is destroyed and the individual spouses each take one-half interests in the property. Although the underlying reasons for the result in each case may differ,[139] the key fact is that only after the entireties estate has been destroyed do the spouses acquire separate interests.

2. Result of a Finding of No Interest in the Entireties Property.—The preceding discussion reveals that an individual spouse has no present interest in entireties property under Indiana law. Thus, had the state not precluded the option, a debtor in Indiana generally would have taken the federal schedule of exemptions. Because the debtor has no interest in entireties property, that property would not have been affected by his bankruptcy. Consequently, his major concern would have been with choosing a schedule of exemptions. The federal schedule[140] sets higher limits and includes more exemptible items of property than the current Indiana schedule.[141] From the debtor's point of view, the federal schedule would have been more advantageous.[142]

The Code's interest test apparently favored the debtor in Indiana, in that he or she might, in most cases, have chosen the federal exemption schedule under section 522(d) and yet subjected none of his or her entireties property to the trustee's claim. Nevertheless, a somewhat ironic situation could have been created. The actual result occasioned by this situation may have been to subject more of the debtor's assets to the claims of creditors than if no interest had been found. To comprehend how finding no interest in entireties property could have been detrimental to a debtor, one must

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[138]IND. CODE § 32-4-4-1 (1976).

[139]With respect to divorce and murder of one spouse by the other, the underlying policy is to achieve equity by dividing the entireties estate. In connection with insanity of one spouse, a more likely justification for dividing the estate is the policy of keeping land alienable.

[140]11 U.S.C. § 522(d) (Supp. II 1978).

[141]IND. CODE § 34-2-28-1 (Supp. 1979).

[142]The exemptions provided by § 522(d) are in general more advantageous to the debtor than those provided by Indiana's House Bill 1359. *See* H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1).

examine the interrelation of the liability of individual spouses for their joint debts, the theory of entireties, and the effect of a discharge in bankruptcy.

Under the Act, views differed about the claims of joint creditors where only one spouse had taken bankruptcy. As a general rule, when a debtor was discharged, his joint and several liability was extinguished.[143] Thus, if a creditor possessed only a promise of the individual debtor to pay, that obligation would be extinguished by the discharge. When only one spouse was in bankruptcy, and entireties property was involved, application of the rule became somewhat more complex. Craig, in his analysis, said that the general rule could be explained as follows:

> A. The individual and joint liability of the bankrupt spouse has been discharged by the bankruptcy proceeding (leaving the other spouse individually liable).
> B. In order for a creditor to reach entirety property (which of course is still held by the bankrupt and his spouse, not having passed to the bankrupt trustee), he must be a 'joint' judgment creditor.
> C. One may become a joint judgment creditor only by obtaining a judgment against both spouses *at the same time*.
> D. If a creditor sues both spouses at the same time and one spouse has been discharged from his joint and several liability in bankruptcy, the suit as to that spouse must be dismissed.
>
> THEREFORE: The joint creditor cannot become a joint judgment creditor and may not levy on entirety property after bankruptcy.[144]

The result, that a joint judgment creditor could not reach entireties property in bankruptcy, without exception, would have worked an injustice upon joint creditors. Therefore, all jurisdictions recognizing entireties provided some means whereby a joint creditor could protect his interest by "obtaining a joint judgment and lien on the entirety property before the bankruptcy of the individual spouse,"[145] or "by requesting a stay of the bankruptcy

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[143]*See* 11 U.S.C. § 32(f) (1976) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549); 1A COLLIER, *supra* note 20, ¶ 14.69 at 1454. The new Code retains this rule. *See* 11 U.S.C. § 524(a) (Supp. II 1978); 3 COLLIER, *supra* note 15, ¶ 524.01[3].

[144]Craig, *supra* note 46, at 284.

[145]Craig, *supra* note 46, at 285. *See, e.g.*, Citizens Sav. Bank v. Astrin, 44 Del. 451, 61 A.2d 419 (1948); Kolakowski v. Cyman, 285 Mich. 585, 281 N.W. 332 (1938).

discharge until a joint judgment and lien can be obtained."[146] The majority of these jurisdictions concluded, however, that unless a judgment and lien were obtained prior to discharge, the joint creditor's claims were barred.[147]

Indiana extended the ability of a joint creditor to protect himself even after the discharge of one joint debtor.[148] The courts ostensibly reasoned that an injustice would result if a joint creditor was precluded from recovering against entireties property merely because he failed to secure a timely judgment and lien.[149]

The theoretical justification for this result in Indiana is unique.[150] In *First National Bank of Goodland v. Pothuisje*,[151] the Indiana Supreme Court held that a joint creditor could obtain a judgment and lien even after discharge because a third form of liability existed in spouses who owned entireties property.[152] The court stated the husband and wife were not only jointly and severally liable, but also liable in their capacity as a marital unit. Thus, although the husband's joint and several liability was extinguished by a discharge in bankruptcy, the entireties liability survived.[153] The court also decided that no part of the entireties estate passed to the trustee in bankruptcy. Therefore, it concluded, "[a]s to property it cannot reach and debts it cannot adjudicate, the judgments and decrees of a court of bankruptcy are inoperative."[154] This decision has been widely accepted in Indiana.[155]

The question then arises whether prior to enactment of House Bill 1359, *Pothuisje* still would have been the law in Indiana. Because an individual spouse does not own an interest in entireties property in Indiana, *Pothuisje* apparently would have controlled. Spouses own no interests in entireties property under Indiana law; thus the bankruptcy estate of an individual debtor could acquire no

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[146]Craig, *supra* note 46, at 285. *See* Phillips v. Krakower, 46 F.2d 764 (4th Cir. 1931); Comment, *supra* note 1, at 64.

[147]Craig, *supra* note 46, at 284; Comment, *supra* note 1, at 645. *E.g.*, Reid v. Richardson, 304 F.2d 351 (4th Cir. 1962); Shipman v. Fitzpatrick, 350 Mo. 118, 164 S.W.2d 912 (1942).

[148]First Nat'l Bank of Goodland v. Pothuisje, 217 Ind. 1, 25 N.E.2d 436 (1940); Craig, *supra* note 46, at 286; Comment, *supra* note 1, at 645.

[149]*See, e.g.*, First Nat'l Bank of Goodland v. Pothuisje, 217 Ind. at 7, 25 N.E.2d at 438 (the court implied this in its discussion).

[150]*See* Craig, *supra* note 46, at 286-87; Comment, *supra* note 1, at 645-46.

[151]217 Ind. 1, 25 N.E.2d 436 (1940).

[152]*Id.* at 11, 25 N.E.2d at 439.

[153]*Id.* at 11-12, 25 N.E.2d at 439-40.

[154]*Id.* at 12, 25 N.E.2d at 440.

[155]*See* Smith v. Beneficial Finance Co., Inc., 139 Ind. App. 653, 218 N.E.2d 921 (1966); Williams v. Lyddick, 116 Ind. App. 206, 61 N.E.2d 186 (1945); Shabaz v. Lazar, 115 Ind. App. 691, 60 N.E.2d 748 (1945).

part of the entireties property. Seemingly, the statement of the court in *Pothuisje* would have remained correct: "As to property it cannot reach and debts it cannot adjudicate, the judgments and decrees of a court of bankruptcy are inoperative."[156] If the discharge in bankruptcy of one spouse had no effect upon the entireties estate under *Pothuisje*, the entireties property could have been reached by joint creditors of the husband and wife.[157]

This Note made the assertion that if an individual debtor had an interest in entireties property, that interest would be included within the bankruptcy estate.[158] In many cases, however, the value of that interest is either zero or insignificant. In addition, in those instances in which a valuable interest is found, the possibility exists that it may be exempted under the household exemption provisions of either the state or federal exemption schedules.[159] The advantage to the debtor of finding some value in the entireties estate would have been that because the entireties interest was included within the estate, any further liability with regard to the property would have been extinguished upon discharge. Finding an interest in every jurisdiction would have destroyed the divergence in views that existed under the Act in connection with the ability of joint creditors to protect themselves, thereby immunizing the entireties property from all creditors in a number of cases.

B. Impact of Indiana's House Bill 1359 upon Tenancies by the Entireties in Bankruptcy

House Bill 1359 provides:

> In accordance with section 522(b) of the Bankruptcy Code of 1978 (11 U.S.C. 522(b)), in any bankruptcy proceeding, an individual debtor domiciled in Indiana:
>
> (1) is not entitled to the federal exemptions as provided by section 522(d) of the Bankruptcy Code of 1978 (11 U.S.C. 522(d)); and
>
> (2) may exempt from the property of the estate only that property specified by Indiana law. . . .
>
> The following property of a debtor domiciled in the state of Indiana shall not be liable for levy of sale on execution or any other final process from a court, for any debt growing out of or founded upon a contract express or implied:

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[156]217 Ind. 1, 12, 25 N.E.2d at 440.

[157]Because entireties property was not affected by a discharge in Indiana, the debtor could have used either the federal or state exemptions prior to the effective date, April 1, 1980, of House Bill 1359. H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1).

[158]*See* text preceding text accompanying note 65 *supra*.

[159]*See* text accompanying notes 103-06 *supra*.

(a) Real estate or personal property constituting the personal or family residence of the debtor or a dependent of the debtor, or estates or rights therein or thereto of the value of not more than seven thousand five hundred dollars ($7,500). The exemption under this subsection shall be individually available to joint debtors concerning property held by them as tenants by the entireties.

(b) Other real estate or tangible personal property of the value of four thousand dollars ($4,000).

(c) Intangible personal property, including choses in action (but excluding debts owing and income owing, of the value of one hundred dollars ($100)).

(d) Professionally prescribed health aids for the debtor or a dependent of the debtor.

(e) Any interest the debtor has in real estate held as a tenant by the entireties on the date of the filing of the petition for relief under the the bankruptcy code, unless a joint petition for relief is filed by the debtor and spouse, or individual petitions of the debtor and spouse are subsequently consolidated.

None of the foregoing provisions of this chapter shall apply to any judgment obtained prior to October 1, 1977.

In no event shall the total of all exempted property under subsections (a), (b) and (c) exceed in value ten thousand dollars ($10,000).[160]

This bill creates a number of problems, concerning entireties property with which the courts and possibly the legislature will have to deal.

1. Section 2(e).[161]—An initial problem created by House Bill 1359 involves the constitutionality of section 2(e). Section 2(e) exempts

> [a]ny interest the debtor has in real estate held as a tenant by the entireties *on the date of the filing of the petition for relief under the bankruptcy code, unless a joint petition for relief is filed by the debtor and spouse, or individual petitions of the debtor and spouse are subsequently consolidated.*[162]

Although this subsection is included within a general exemption statute, its applicability is limited to bankruptcy proceedings. By

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[160]H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1).

[161]*Id.* § 2(e).

[162]*Id.*

creating an exemption applicable only in bankruptcy, this subsection may violate the supremacy clause[163] of the United States Constitution.

The Supreme Court in *International Shoe Co. v. Pinkus*[164] held that "[t]he power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount."[165] The Court also maintained that "[s]tates may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations."[166] Section 522(b) of the Bankruptcy Reform Act of 1978 provides a debtor with a choice between two sets of exemptions—those established by section 522(d) or those existing under applicable nonbankruptcy law. Thus, states are permitted to enact nonbankruptcy exemption statutes which apply generally to all debtor-creditor relationships. Nevertheless, under the language of *International Shoe*, provisions for exemptions applicable solely in bankruptcy would appear to be improper because they "complement the Bankruptcy Act or . . . provide additional or auxiliary regulations."[167] For this reason, a constitutional attack upon House Bill 1359 on grounds that it violates the supremacy clause may be justified.

Further support for the view that section 2(e) is unconstitutional is found in the 1974 Ninth Circuit Court of Appeals case of *Kanter v. Moneymaker*.[168] *Kanter* involved a claim by the trustee in bankruptcy to a personal injury claim that arose from an automobile accident involving the bankrupt. The accident occurred just prior to the filing of his petition in bankruptcy.[169] The trustee claimed the cause of action as an asset of the estate and sought to have this claim established by the bankruptcy court.[170] The judge ruled in favor of the trustee and the district court affirmed.[171] On appeal, the bankrupt argued that a California statute[172] made a personal injury action exempt from claims of the trustee.[173] The district court had held this statute invalid under the supremacy clause and the court of appeals concurred.[174]

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[163]U.S. CONST. art. VI, cl. 2.
[164]278 U.S. 261 (1929).
[165]*Id.* at 265.
[166]*Id.*
[167]*Id.*
[168]505 F.2d 228 (9th Cir. 1974).
[169]*Id.* at 229.
[170]*Id.*
[171]*Id.*
[172]CAL. CIV. PROC. CODE § 688.1(b) (West Supp. 1980).
[173]505 F.2d at 230.
[174]*Id.*

The Ninth Circuit explained that this statute was defective because it limited only the bankruptcy trustee's ability to reach the personal injury claim and not the ability of other creditors to reach it.[175] Although the state could properly broaden the classes of property which were exempt from claims of all creditors, it could not constitutionally make an interest in property exempt from the claims of the trustee alone.[176] Section 2(e) of House Bill 1359 possesses a limitation similar to that which existed in the California statute. In attempting to make tenancies by the entireties exempt only in bankruptcy, section 2(e) arguably violates the supremacy clause.

Moreover, making entireties property absolutely exempt, as section 2(e) purports to do, is unreasonable because of the possibility for abuse. An absolute exemption, in connection with conversion of nonexempt assets to exempt assets, might allow a debtor to avoid the claims of all creditors. The old rule, that conversion of nonexempt property into *entireties* property constituted a fraud upon creditors,[177] will be changed if House Bill 1359 makes entireties property absolutely exempt. The general rule provides that a debtor may convert *nonexempt* property into *exempt* property without working a fraud upon his creditors.[178] If entireties is now absolutely exempt under section 2(a), such a conversion of nonexempt property to entireties property should be permitted. Because of this change, a debtor anticipating bankruptcy could sell all of his or her nonexempt assets and use the proceeds to purchase real property which the debtor and his or her spouse take as tenants by the entireties. This conversion would not be fraudulent under the law and yet would allow the debtor to receive all the benefits of a discharge in bankruptcy while subjecting none of his or her property to the claims of creditors in bankruptcy.

2. Section 2(a).[179]—If one assumes that section 2(e) is invalid under the supremacy clause, the only provision of House Bill 1359 applicable to entireties would be section 2(a). A number of problems and questions also arise with regard to section 2(a).

a. If entireties is part of the bankruptcy estate.—If entireties property is part of the bankruptcy estate, the first problem involves reconciling the Indiana common law theory, that because an individual spouse has no interest in entireties property no interest will pass to his or her bankruptcy estate, with the necessity that property to be

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[175]*Id.* at 230-31.

[176]*Id.*

[177]*See* notes 76-77 *supra* and accompanying text.

[178]*See* note 73 *supra* and accompanying text.

[179]H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., § 2(a), 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1).

exempted must first have passed into the bankruptcy estate. To decide whether entireties property becomes a part of the bankruptcy estate under the Code, one must determine whether an individual spouse has an interest in such property. One must generally resort to state law to make this determination. Indiana common law provides that individual spouses have no interest in entireties property;[180] therefore, under Indiana common law no entireties property will pass into the bankruptcy estate. Section 2(a) of House Bill 1359, however, states that a personal or family residence held as tenants by the entireties is exempt to the extent of $7,500 to each spouse.[181] For property to be exempt, it must first be part of the bankruptcy estate, and for property to be part of the estate, the debtor must have an interest in it. Section 2(a) of House Bill 1359 and Indiana common law are clearly inconsistent.

The possibility exists that the legislature made entireties exempt to insure its protection, regardless of the construction given the Code regarding that statute. Yet, this action creates an interpretive impasse. Either the common law controls, providing that individual spouses own no interest in entireties property, or the legislature has overruled—but only by implication—the common law, thereby allowing individual spouses to own interests in entireties property.

If one assumes that the legislature has overruled the common law to recognize an interest in entireties property in the individual spouses, a question exists about the extent of that interest. Ostensibly, there are at least three possible answers: the spouses may each hold undivided one-half interests in the entireties estate; the spouses may each hold an interest in the whole estate according to the proportion of the consideration they individually contributed toward acquisition of the property; or the spouses may each hold an interest based upon their proportionate share in the usufruct, plus the value to the spouse of his or her future survivorship interest.[182]

In addition, if entireties property does become a part of the bankruptcy estate under section 2(a), the rights of creditors will be altered. Section 2(a) expressly gives both a husband and wife with

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[180]*See* note 113 *supra* and accompanying text.

[181]H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., § 2(a), 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1).

[182]The value to the individual spouse of this interest could vary depending upon such factors as his or her age and health which are taken into consideration in computing the value of the survivorship. In addition, under common law analysis it is conceivable, although improbable, that the courts could find that the spouse's share in the usufruct but not the future survivorship would pass into the bankruptcy estate. Conversely, the courts could find that the survivorship interest but the usufruct would pass into the bankruptcy estate.

entireties property an exemption in their personal or family residence against creditors holding their joint obligation. This provision thus overrules prior Indiana law holding that the marital entity has no claim to an exemption for entireties property.[183] Section 2(a) is also sufficiently broad to provide each spouse with the same $7,500 exemption against creditors with individual claims against one spouse or the other. The $7,500 household exemption, therefore, applies against both individual creditors and creditors with joint claims.

(i) Examples.—By assuming that each spouse holds a one-half interest in the entireties estate that passes to the trustee in bankruptcy, one can examine the effect of section 2(a) upon the entireties estate. If the spouses are jointly liable on a debt, and only one of them, for example the husband, goes into bankruptcy, the one-half interest of the husband will become part of his bankruptcy estate. He will, however, be entitled to a $7,500 exemption under section 2(a). The husband's interest, therefore, will be subject to the claims of both his joint and individual creditors. Upon discharge, all liability of the husband will be extinguished. If the entireties property is sold or partitioned in bankruptcy, the wife's one-half interest in the division or proceeds probably will be subject to the claims of individual and joint creditors against whom she can claim her $7,500 exemption. This in effect assumes that bankruptcy makes the spouses tenants in common.

If the spouses are not jointly liable on a debt and only the husband goes into bankruptcy the result will be the same as above. However, no interest of the wife, either in entireties or other property, will be subject to the claims of her husband's individual creditors. If the spouses are not jointly liable on a debt and both are in bankruptcy, then the individual one-half interest of each will pass into his or her bankruptcy estate. Each spouse will be entitled to a $7,500 exemption with the balance of the value of the entireties property remaining in the bankruptcy estate to satisfy the claims of individual creditors. If the spouses are jointly liable on a debt and each files a petition in bankruptcy, the result will again be essentially the same. Yet, in this situation the balance of the value of entireties property in excess of the exemption remaining in the bankruptcy estate of each spouse may be used by the trustee to satisfy claims of joint as well as individual creditors.

(ii) Summary.—The results under section 2(a) of House Bill 1359 will differ from those that existed under the old Act. If the spouses do have interests in entireties property under section 2(a), those interests become a part of the bankruptcy estate. Once the in-

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[183]Sharpe v. Baker, 51 Ind. App. 547, 571, 99 N.E. 44, 46-47 (1911).

terest becomes part of the estate, all creditors, whether joint or individual, will share equally in the property. This follows because distributions in bankruptcy make no differentiation between joint and individual creditors. For example, in the first situation discussed above—in which the spouses are jointly liable but only one spouse is in bankruptcy—none of the entireties property would have been subject to the trustee's claims under the Act.[184] Individual creditors received no benefit from the entireties property, and joint creditors outside of bankruptcy were entitled to all the entireties property. Under House Bill 1359, the husband's interest will become part of

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[184]The trustee may, however, have some control over entireties property for marshaling purposes. Marshaling has been defined as the "principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." Sowell v. Federal Reserve Bank, 268 U.S. 449, 456-57 (1925).

An interesting problem of marshaling arises in bankruptcy when a creditor holding the joint obligation of husband and wife with a right to reach entireties property files a claim against the estate of one of the spouses in bankruptcy. Under principles of marshaling will the creditor be required to exhaust his claim against the entireties property before he can share in any distribution from the estate? Or must the joint creditor show that he has exhausted his claim against the bankrupt before he proceeds against entireties property? If the bankrupt is primarily liable upon the obligation, it seems that his individual property or the bankrupt estate should first be exhausted. *See* First Nat'l City Bank v. Phoenix Mut. Life Ins. Co., 364 F. Supp. 390 (S.D.N.Y. 1973) (mortgagee with lien on husband's entireties property and life insurance policies could not be compelled to satisfy claim from the entireties property first, with respect to creditor with lien only on the insurance policies, where the effect was to defeat the wife's right of survivorship to the entireties property); *In re* Estate of Smith, 388 N.E.2d 287 (Ind. Ct. App. 1979) (creditor of husband with lien on individual and entireties property required to exhaust individual collateral first); Miller Lumber & Coal Co. v. Berkheimer, 342 Pa. 329, 20 A.2d 772, 135 A.L.R. 736 (1941) (husband's creditor with lien on individual and entireties property may satisfy claim from the individual property first). *Contra*, Berman v. Green (*In re* Jack Green's Fashions for Men—Big and Tall, Inc.) 597 F.2d 130 (8th Cir. 1979) (lienholder with lien on entireties and individual property of husband requried to exhaust entireties property first where resort to individual property would leave nothing for general creditors).

If the bankrupt spouse is secondarily liable on the joint obligation of husband and wife, the creditors holding a joint claim should be required to exhaust entireties property before participating in the bankrupt estate under general principles of marshaling. *Cf.* Consumers Time Credit, Inc. v. Remark Corp., 248 F. Supp. 158 (E.D. Pa. 1965) (lienholder with lien on both entireties property and life insurance policy required to assert lien on the entireties property first thereby preserving the interest of a lienholder with a junior lien on the life insurance policy). IND. CODE §§ 34-1-55-1 to 4 (1976) (allowing surety to require creditor to exhaust remedies against principal first).

But if the bankrupt and his spouse are equally and jointly liable to a creditor, it is logical that his individual property or the bankrupt estate should be primarily liable to the extent of one half of the obligation—*i.e.*, the extent to which the individual in bankruptcy is liable for contribution. *See, e.g.*, McLochlin v. Miller, 139 Ind. App. 443, 217 N.E.2d 50 (1966) (estate of deceased spouse required to pay one half of mortgage indebtedness on entiretes property upon which both equally liable).

the estate and the joint creditors will have to share that interest with other creditors.

b. If entireties is not part of the bankruptcy estate.—Heretofore, it has been assumed that individual spouses do have interests in entireties property under section 2(a) of House Bill 1359. If, however, the common law is sustained by courts ruling that individual spouses do not have interests in entireties property, very little will change as a result of House Bill 1359. If neither spouse has an interest in entireties property, no interest in that property can pass into the bankruptcy estate of an individual spouse. The trustee will acquire no power over the property and individual creditors will not share in it. *Pothuisje* will continue to control.[185] Thus, the discharge of one spouse in bankruptcy will not affect the entireties estate in Indiana. Joint creditors will be able to reach entireties property prior to and following discharge. Significantly, however, section 2(a) will enable the debtor and his or her spouse together to exempt up to $15,000 worth of individual or family residential property from the claims of joint creditors. Moreover, the husband and wife may convert up to $15,000 in nonexempt assets to individual or family residential entireties property on the eve of bankruptcy and claim it exempt. In this sense, the new Indiana exemption law has not interfered with rights of creditors to the extent which might have occurred under section 2(e).[186]

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[185]*See* text accompanying notes 151-56 *supra.*

[186]For a discussion of conversion under section 2(e) *see* section IV B. 1 of this Note. Beyond questions involving entireties, however, House Bill 1359 does create other problems. The Indiana General Assembly obviously was aware of the federal exemption provisions since it specifically referred to § 522 in its bill. *See* H.B. 1359, 101st Ind. Gen. Ass., 2d Sess., 1B Adv. Legis. Serv. 1660 (1980) (to be codified at IND. CODE §§ 34-2-28-0.5, -1). Yet, it declined to include a number of provisions that were included within the federal schedule of exemptions. These omissions might be interpreted to indicate a legislative intent that these excluded items of and interests in property be included within the bankruptcy estate.

Section 522(d)(10)(D) of the federal exemption schedule, for example, provides that a "debtor's right to receive alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor" is exempt. 11 U.S.C. § 522(d)(10)(D) (Supp. II 1978). House Bill 1359 provides no exemption for these items. Because no state or federal statute exists to exempt such interests, they will become a part of the bankruptcy estate. Therefore, if a wife receives support or separate maintenance payments and declares bankruptcy, it appears that the payments by the husband will pass to the wife's trustee in bankruptcy and the wife will receive no part of them with which to support herself or her children.

Another provision omitted in House Bill 1359 concerns wrongful death recoveries. Section 522(d)(11)(B) provides that "[t]he debtor's right to receive, or property that is traceable to a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor" is exempt. 11 U.S.C. § 522(d)(11)(B) (Supp. II

CONCLUSION

If a particular state has determined that each spouse holds a separable interest in the entireties estate, whatever its quality, that interest will pass to the trustee in bankruptcy. The most difficult problem, however, lies in assigning a value to the interest which passes to the trustee. Once a value has been assigned, the interest may be claimed by the debtor under the bankruptcy exemptions or, if the debtor elects the state exemptions, the interest may be claimed by the debtor to the extent permitted under state law.

Before enactment of the Code, some states had recognized that an individual spouse held some interest in entireties property. In these jurisdictions, the problem of valuing that interest remains. If an individual spouse in bankruptcy takes the exemptions of section 522(d), the value of his interest in the entireties property most likely will remain exempt. If he claims the state exemptions under section 522(b), the pre-Code law of the state will determine which interest creditors may reach.

In some states, such as Indiana, the individual spouse has no interest in entireties property. If section 541 does not include entireties property within the bankruptcy estate of a spouse because the spouse has no interest in the property which may pass to the trustee, the law with respect to entireties property in bankruptcy basically remains unchanged by the new Code.

The individual spouse-debtor may take either the federal bankruptcy exemptions under section 522 or claim the state exemptions and still hold entireties property free from the claims of his individual creditors. Joint creditors, however, may reach entireties property through in rem claims outside of bankruptcy, subject to the applicable rules of marshaling.

Indiana has introduced an important modification to the pre-Code law by allowing each spouse to claim as exempt against joint creditors home property to the extent of $7,500. When reduced to

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1978). House Bill 1359 fails to mention wrongful death recoveries. Wrongful death recoveries apparently become part of the bankruptcy estate.

A final example of an item omitted from the Indiana statute is tort claims. Section 522(d)(11)(D) provides that "[t]he debtor's right to receive, or property that is traceable to a payment, not to exceed $7,500, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent" is exempt. 11 U.S.C. § 522(d)(11)(D) (Supp. II 1978). Because House Bill 1359 fails to mention tort claims and no other state or federal statute expressly makes such claims exempt, the proceeds of a tort recovery will pass to the trustee in bankruptcy. House Bill 1359, however, does provide an intangibles exemption of $100. Thus, to that extent the debtor may claim an exemption for his tort claim; however, he will receive no benefit from the tort recovery in excess of the $100 exemption.

its fundamental terms, however, the new Indiana law with respect to entireties property passing to the bankruptcy estate under section 541 leaves unanswered the question whether an individual spouse has an interest in entireties property which will pass to the estate.

MARK R. WENZEL

The Efficiency of Liberalizing Branch Banking in Indiana

I. INTRODUCTION

The Great Depression and its bank runs resulted in approximately five thousand bank failures between 1929 and 1933 and the loss of nine million customer savings accounts.[1] Fearing a recurrence of the catastrophic set of circumstances which led to this result, state legislatures passed remedial legislation to deal with the evils of the banking industry.[2] The main thrust of this legislation was to protect the economy and the public from bank failures and their side-effects.[3] The prevailing view of the era during and following the Great Depression attributed bank failures to "excessive competition among banks and imprudent banking practices."[4] Accordingly, the power of state banking regulatory authorities to police the banking industry and prohibit or restrict entry into the banking field was strengthened.[5] Although not all states chose to restrict branch banking,[6] the majority of states imposed restrictions upon a bank's right to establish a branch bank.[7]

In passing restrictive bank branching laws, the legislatures impliedly chose to give consumers fewer banking alternatives. This legislative choice was made during the Depression Era when safety and not efficiency was the pressing need in the banking industry. Consequently, many states, including Indiana, imposed geographical

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[1]Central Bank v. State Banking Bd., 509 S.W.2d 175, 183 (Mo. Ct. App. 1974) (citing W. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL 18 (1963)).

[2]On the federal level, remedies included the creation of the Federal Deposit Insurance Corporation which functioned as an insurer of depositors' accounts up to a specified level. Federal Deposit Insurance Act, 12 U.S.C. § 1811 (1976). The insurance was intended to relieve the anguish of small depositors, protect circulating money, and help sustain a system of small unit banks. W. LEUCHTENBURG, *supra* note 1, at 60.

[3]Central Bank v. State Banking Bd., 509 S.W.2d 175, 183 (Mo. Ct. App. 1974).

[4]*Id. See generally* Kreps, *Modernizing Banking Regulations*, 31 LAW & CONTEMP. PROB. 648, 651 (1966); Stokes, *Public Convenience and Advantage in Applications for New Banks and Branches*, 74 BANKING L.J. 921, 922-23 (1957).

[5]Central Bank v. State Banking Bd., 509 S.W.2d 175, 184 (Mo. Ct. App. 1974).

[6]Branch banking is generally said to exist when a bank conducts its banking operations at two or more places. *See* E. REED, R. COTTER, E. GILL, & R. SMITH, COMMERCIAL BANKING 16 (1976).

[7]For an overview of the various state branch banking laws, *see generally* Gup, *A Review of State Laws on Branch Banking*, 88 BANKING L.J. 675 (1971); Hablutzel, *State Regulation of Branch Banking*, 16 DUQ. U. L. REV. 679 (1978); Note, *Branch Banking—Restrictive State Laws Considered in Light of the Public Interest—Extension of National Power Over Banking*, 38 NOTRE DAME LAW. 315 (1963) [hereinafter cited as Note, *Branch Banking*].

restrictions upon a bank's right to establish a branch bank and required a showing that the proposed branch would promote the public convenience or advantage.[8]

The bank branching statute in Indiana[9] imposes six requirements upon a bank seeking to establish a branch: (1) the proposed branch must be within the county in which the bank's main office is located; (2) the bank must have sufficient capital to support the proposed branch; (3) the proposed branch must subserve and promote

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[8]*See* IND. CODE § 28-1-17-1 (1976).

[9]IND. CODE § 28-1-17-1 (1976) provides:

Branch banks.—In all counties having a population of less than five hundred thousand [500,000] inhabitants, according to the last preceding decennial United States census, or in counties having three [3] or more cities of the second class, except as hereinafter otherwise provided, any bank or trust company may open or establish a branch bank in any city or town within the limits of the county in which the principal office of such bank or trust company is located, if there is no bank or trust company located in such city or town. In all counties, any bank or trust company may open one [1] branch bank for each two hundred thousand dollars [$200,000] of the capital and surplus of such bank or trust company, actually paid in and unimpaired. In all counties having a population in excess of five hundred thousand [500,000] inhabitants according to the last preceding decennial United States census, and not having three [3] or more cities of the second class, any bank or trust company may open or establish a branch bank in any city or town within the limits of the county in which the principal office of such bank or trust company is located.

No branch bank shall be opened or established without first having obtained the written approval of the department. The location of any branch bank may be changed at any time when such change of location is authorized by the board of directors of the bank or trust company and approved by the department. Any bank or trust company desiring to establish one or more branches shall file a written application therefore, in such form, and containing such information as may be prescribed by the department. The department is hereby authorized, in its discretion, to approve or disapprove any application. Before the department shall approve or disapprove any application for the establishment of a branch bank, as herein authorized, it shall ascertain and determine to its satisfaction that the public convenience and advantage will be subserved and promoted by the opening or establishment of a branch bank in the community in which it is proposed to establish such branch bank; in the case of counties having a population of less than five hundred thousand [500,000] according to the last preceding decennial United States census, or in counties having three [3] or more cities of the second class, that there is no bank or trust company located in the city or town in which it is proposed to establish such branch bank, if the application is for a permit to open or establish a branch bank in a city or town other than that within which the applicant bank or trust company is located; that the applicant bank or trust company has satisfied the capital and surplus requirements, as hereinabove provided. No branch bank may be opened if the real estate (as defined in IC 1971, 28-1-11-5) of the bank or trust company establishing such branch bank will thereby exceed the capital and surplus of such bank or trust company actually paid in and unimpaired.

the "public convenience and advantage;" (4) the location of the proposed branch must be a "city or town;" (5) the proposed branch may not be located in a town in which another bank's main office is located unless the city or town is also where the main office of the applicant bank is located (the "home office protection" provision); and (6) the bank's investment in real estate, including the proposed branch, must be within certain limits.[10]

These statutory requirements regarding branch banking have changed little since the enactment of the branching statute in 1933.[11] Although legislative policy still favors safety in the banking industry, the courts now are also emphasizing greater efficiency in the banking industry. Indeed, branch banking has the virtue of promoting greater competition among banks, thereby encouraging better bank services and lower costs for these services.[12] This judicial movement emphasizing efficiency is logical because the banking system is no longer threatened by the evils which almost destroyed it nearly a half-century ago. The Indiana courts have achieved greater efficiency by liberally construing "city or town" for purposes of locating a proposed branch, by narrowly construing "city or town" for purposes of applying the home office protection provision, and by pragmatically defining "public convenience and advantage."

Although an increase in branch banks promotes greater efficiency, strong arguments have been voiced in opposition to bank branching. Some commentators have argued that branch banking not only creates a monopoly[13] but also leads to an impersonal bank which neglects the needs of the local community[14] or results in inadequate supervision, thereby reducing the safety of a banking system.[15] Regardless of philosophy about the virtues of branch banking, attention should be given to the current judicial trend in Indiana which

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[10]*Id.*

[11]The 1980 session of the Indiana General Assembly defeated a bill which would have allowed banks to compete on a state-wide basis. *See* H.B. 1246, 101st Ind. Gen. Ass., 2d Sess. (1980) (engrossed); S. 329, 101st Ind. Gen. Ass., 2d Sess. (1980) (engrossed). The bill would have circumvented the Indiana branch banking law by allowing a holding company to purchase up to four Indiana banks per year, regardless of their location. Thus, a bank could establish facilities outside its home county by simply buying a bank located in another county without regard to the Indiana branching restrictions. The successful opponents of the bill favored local ownership of local banks. The arguments opposing the bill were typical arguments used to oppose expansion of branching: local banks would pay larger dividends and charge lower rates than big city banks; local banks, as a "cornerstone" of the community, should be locally controlled and local banks would be driven out of business if forced to compete with big city banks. *See* Indianapolis Star, Feb. 20, 1980, at 1, col. 5.

[12]*See* E. REED, *supra* note 6, at 38; Hablutzel, *supra* note 7, at 724.

[13]*See* E. REED, *supra* note 6, at 43; Hablutzel, *supra* note 7, at 723-24.

[14]*See* E. REED, *supra* note 6, at 43; Hablutzel, *supra* note 7, at 723-24.

promotes efficiency in the banking system by increasing the number of branch banks while preserving the soundness of the state banking system.

II. DEFINITION OF "CITY OR TOWN"

A branch bank in Indiana may only be located in a "city or town."[16] What constitutes a "city or town" is not, however, addressed by the state bank branching statute. Consequently, these terms have been defined by the courts rather than the legislature. In a 1953 opinion,[17] the Indiana Attorney General concluded that the word "town" should be given its usual and ordinary meaning.[18] The attorney general explained that this practical definition allows a town to be unincorporated or incorporated for purposes of locating a branch bank.[19] Although he offered no persuasive reason for this conclusion, the Supreme Court of New Jersey in *Montclair National Bank & Trust Co. v. Howell*[20] offered a logical basis for this definition. The court in *Montclair* rejected an argument that the New Jersey branching statute, requiring that conditions *in the locality* of the proposed branch offer the branch a reasonable chance of success, should be interpreted to require that conditions *in the political subdivision* of the proposed branch offer the branch a reasonable chance of success.[21] The court reasoned that banking, like other human activities, was not confined to political boundaries and that the whole area that the proposed branch would be expected to serve was a more realistic method of determining whether an area could support the branch.[22] In this sense the court assigned "locality" its usual meaning of "trading area."[23] Pennsylvania has also reached this result. In *Upper Darby National Bank v. Myers*,[24] the Supreme Court of Pennsylvania concluded that a "community" was not limited by municipal lines and boundaries.[25] Indeed, a community could also be an area with a common residential, social, business, commercial, or industrial interest. The court observed that the legislature could have used a more precise word such as "township"

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[15]*See* Note, *Branch Banking*, *supra* note 7, at 319.

[16]IND. CODE § 28-1-17-1 (1976).

[17][1953] OP. IND. ATT'Y GEN. 152.

[18]*Id.* at 154-55. The attorney general observed that a city is nothing more than a large town. *Id.* at 155. Consequently attention will be focused on the definition of town.

[19]*Id.* at 156.

[20]32 N.J. 29, 159 A.2d 113 (1960).

[21]*Id.* at 43, 159 A.2d at 120-21.

[22]*Id.* at 43, 159 A.2d at 121.

[23]*Id.* at 45-46, 159 A.2d at 122.

[24]386 Pa. 12, 124 A.2d 116 (1956).

[25]*Id.* at 19, 124 A.2d at 119.

rather than "community" if it intended to reach the opposite result.[26]

Although the Indiana Attorney General concluded his opinion by advising that "the term 'town' includes an unincorporated as well as an incorporated town,"[27] the courts have had the difficult task of determining what characteristics an unincorporated area needs to qualify as a "town" within the meaning of the branching statute. It is the imprecision of this definition which has afforded the courts the opportunity and flexibility to promote more efficient banking operations.

The first judicial attempt to define "town" under the Indiana branching statute occurred in *First National Bank v. Camp*,[28] a 1971 opinion of the United States District Court for the Northern District of Indiana. The plaintiff (hereinafter First National), challenged the approval by the United States Comptroller of the Currency (hereinafter Comptroller) of an application for a certificate of authority to establish a branch bank. First National contended that the Comptroller's action violated the bank branching laws of Indiana[29] since the unincorporated location selected for the proposed branch was not a "city or town" as provided in the Indiana statute.

Faced with the issue whether the unincorporated area was a "city or town," the district court was guided by the previously discussed 1953 opinion of the Indiana Attorney General[30] and a line of Michigan cases construing the comparable term of "village" under the Michigan branch banking statute.[31] One Michigan court has stated:

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[26]*Id.*

[27][1953] OP. IND. ATT'Y GEN. at 156.

[28]342 F. Supp. 871 (N.D. Ind. 1971), *aff'd*, 463 F.2d 595 (7th Cir. 1972).

[29]A national bank must apply to the Comptroller of the Currency for permission to establish a branch bank. 12 U.S.C. § 36(c) (1976) provides in part:

> A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: . . . (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks.

Thus a national bank may establish branch banks in any state to the extent that the state banks of that state may do so. First Nat'l Bank v. Walker Bank & Trust Co., 385 U.S. 252 (1966).

[30]342 F. Supp. at 875 (citing [1953] OP. IND. ATT'Y GEN. 152).

[31]342 F. Supp. at 875-76 (citing American Bank & Trust Co. v. Saxon, 373 F.2d 283 (6th Cir. 1967); Community Nat'l Bank v. Saxon, 310 F.2d 224 (6th Cir. 1962); National Lumberman's Bank & Trust Co. v. Camp., Civil No. 6179 (W.D. Mich. May 4, 1970) (unreported opinion by Kent, Chief Judge, attached as Appendix A to Comptroller's Memorandum in Support of his Motion to Dismiss); Security Bank v. Saxon, 298 F. Supp. 991 (E.D. Mich. 1968); Peoples Bank v. Saxon, 244 F. Supp. 389 (E.D. Mich. 1965);

> The word "village" is not a technical word, or one having a peculiar meaning, but is a common word in general usage with an ancient lineage. It is merely an assemblage or community of people, a nucleus or cluster for residential and business purposes, a collective body of inhabitants, gathered together in one group.[32]

This definition does not, however, furnish any clear criteria for determining the existence of a village. In *Bank of Dearborn v. Taylor*,[33] the Michigan Supreme Court clarified its earlier definition of "village." The court, in adopting the reasoning of the trial court that the area in question was a "village," focused upon economic rather than geographic or political factors.[34] The area was found to constitute a separate "trading area" with a cluster of residences and businesses.[35] The court also took special notice of the area's *potential* for growth.[36]

Such a determination based upon these factors suggests that the Michigan courts are looking for an area which is a "center" of personal and business activity. This approach is intuitively sensible, because an area possessing a "center of gravity" would benefit from the services provided by a branch. By requiring a combination of business and personal activities in the area in issue, the courts are also assuring a long-term settlement which will support the branch in future years as well as the year in which the application is filed. The validity of this observation is strengthened by the denial of a branch application in *Peoples Bank-Trenton v. Saxon*[37] for failure to show that the proposed location of the Michigan bank branch was a "village."[38] The area in question contained three separate, yet unconnected, clusters of business places.[39] The court also found no indication of a probable change in these conditions in the future.[40] Consequently, the area did not meet the Michigan definition of "village."

Commercial State Bank v. Gidney, 174 F. Supp. 770 (D.D.C. 1959); Bank of Dearborn v. Taylor, 365 Mich. 567, 114 N.W.2d 210 (1962); Wyandotte Sav. Bank v. Eveland, 347 Mich. 33, 78 N.W.2d 612 (1956); National Bank v. Detroit Bank & Trust Co., 19 Mich. App. 439, 172 N.W.2d 883 (1969)).

[32]Wyandotte Sav. Bank v. Eveland, 347 Mich. 33, 41, 78 N.W.2d 612, 617 (1956), *quoted in* First Nat'l Bank v. Camp, 342 F. Supp. at 876.

[33]365 Mich. 567, 114 N.W.2d 210 (1962).

[34]*Id.* at 571-72, 114 N.W.2d at 212-13.

[35]*Id.*

[36]*Id.* at 572, 114 N.W.2d at 213.

[37]244 F. Supp. 389 (E.D. Mich. 1965).

[38]*Id.* at 393.

[39]The court stated, "The body of people are not gathered in one group; there is no community center for a nucleus, no professional offices, no centralized populous area, no school or church and no general common residential or business activity." *Id.*

[40]*Id.*

The district court in *First National Bank* decided that the definition of "village" under Michigan law was "substantially in accord with the opinion of the Attorney General of Indiana . . . , and the subsequent interpretive application of it to branch banking in Indiana."[41] Because the Comptroller had denied a previous application by the applicant bank to establish a branch in approximately the same location three years earlier, the court stated that "[t]he only real determination the Comptroller had to make [on the bank branch application in question] was whether the area had developed to the point where it could be considered a city or town."[42] The Comptroller placed great weight upon a *proposed* Lake County Courthouse complex in ruling upon the second application. The Comptroller felt the proposed complex would provide "a nucleus for the establishment of new service, business and commercial establishments, in addition to the business activity which it will generate per se,"[43] thus taking into account "planned development of the area which would affect its character in the immediate future."[44] The court also noted that the Comptroller considered the increase in residential single family units and population of the area over the three-year span between the two applications.[45] The court found that under these facts, "the Comptroller's action in determining, as a matter of fact, that the area within which [applicant bank] wished to establish a branch bank was a town within the meaning of the Indiana statute" was acceptable.[46]

An important aspect of this decision is the court's reliance upon the potential growth of the area. This is a major departure from the policy of providing a safe banking system and toward a policy of providing an efficient banking system for the customer. The Indiana courts have not yet been given the opportunity to state Indiana's official position regarding the area's potential for growth, although the *First National Bank* decision offers persuasive support for choosing a more efficient banking system.

Recent Indiana decisions indicate acceptance of the *First National Bank* criteria for a "town." The Indiana Supreme Court, in *Pendleton Banking Co. v. Department of Financial Institutions* adopted a liberal definition of "town."[47] The appellants had opposed an order of the Indiana Department of Financial Institutions approv-

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[41]342 F. Supp. at 876.
[42]*Id.*
[43]*Id.* at 877.
[44]*Id.*
[45]*Id.*
[46]*Id.*
[47]257 Ind. 363, 274 N.E.2d 705 (1971).

ing an application to establish a branch in Huntsville, Indiana. Huntsville did not have a fire department, school, or church. The appellants contended that the location of the proposed branch, an unincorporated area, did not meet the criteria of the 1953 Attorney General's opinion.[48] The court disagreed,[49] refusing to hold that every factor mentioned in the 1953 Attorney General opinion must be present in an area before the area could be considered a town:

> We think it is clear that the statute as interpreted by the Attorney General uses the word "town" to include a compact area having a number of persons living in close proximity to one another with some degree of business being transacted within the area. Each case requires a factual determination as to whether or not the area can be in fact considered a town.[50]

The Court reasoned that sufficient evidence existed to support a finding that Huntsville was a town, observing that there were several businesses in Huntsville, that the population of Huntsville was growing, and that the area needed a branch bank.[51]

By this ruling, the court rejected the argument that the area must contain a minimum population before it can be a "town" within the meaning of the statute.[52] The 1953 opinion of the Indiana Attorney General[53] required at least 1500 to 1800 persons for an area to qualify as a town.[54] Nevertheless, the court found this requirement to be inapplicable in this situation.[55] The court decided that each case involving the determination of a "town" for bank branching purposes should be considered on its own facts,[56] thus freeing the courts from rigid standards and affording the courts the opportunity to liberalize the branching law of Indiana.

The courts have, however, continued to temper each determination with a consideration of safety. In *Albion National Bank v.*

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[48][1953] Op. Ind. Att'y Gen. 152.

[49]The appellant's specific contention was as follows:

> [T]he facts observed in the Attorney General's Opinion set forth a rigid standard which must be met before an unincorporated area may be considered to be a town; that it must have church, a school, fire department, retail stores, boarding houses and at least 500 residences located on various streets and alleys, and a population of from 1500 to 1800 persons.

257 Ind. at 367, 274 N.E.2d at 708.

[50]*Id.* at 367-68, 274 N.E.2d at 708.

[51]*Id.*

[52]*Id.*

[53][1953] Op. Ind. Att'y Gen. at 155.

[54]*Id.* (citing Pollard v. Montana Liquor Control Bd., 114 Mont. 44, 131 P.2d 974 (1942)).

[55]257 Ind. at 367-68, 274 N.E.2d at 708.

[56]257 Ind. at 368, 274 N.E.2d at 708.

Department of Financial Institutions,[57] the Indiana Court of Appeals held that the proposed location of a branch was not a town.[58] The court applied the *Pendleton* test of "a compact area, . . . [which requires] . . . (1) a number of persons living in close proximity to one another, and (2) some degree of business being transacted,"[59] to determine if the proposed site was within a "town." The court found the following inadequate to qualify the area as a town: businesses consisting of appliance sales, mobile homes sales, automobile sales and service, general contractors, builders and realtors[60] to the east of the site; one house and a church to the immediate west; a saddle club, farmhouse, veterinarian building, and house in the immediate vicinity; and one house located upon the site.[61] Assessing the number of persons residing in the area, the court decided that "[t]hese few residences clearly would not constitute a number of persons living in close proximity of one another."[62] Examining the question of business activity, the court observed four different clusters of business activity[63] but found "no indication that any of the clusters have any nexus with any other so as to be considered a compact area with regard to the proposed site."[64] The court indicated that a dependency must exist between the different clusters of residences and businesses. Although this requirement hampers further judicial movement in liberalizing the concept of "town," some restrictions are necessary to assure a safe banking system. Without this requirement, a branch located on the outer fringes of two or more incorporated towns could fail if each fringe group did its business in its respective incorporated town. Such a result would be less likely to occur if there existed an attraction or nexus between the fringe groups and the area.

The United States Court of Appeals for the Seventh Circuit recently rendered a decision which turned upon Indiana's definition of "town" in its bank branching statute. *First Union Bank & Trust Co. v. Heimann*[65] involved an order of the Comptroller approving the

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[57]355 N.E.2d 873 (Ind. Ct. App. 1976).

[58]*Id.* at 877.

[59]*Id.*

[60]*Id.* at 875.

[61]*Id.* at 877.

[62]*Id.*

[63]These included a housing development, bowling alley, restaurant and church 1.1 miles northwest of the proposed site, the Lyall Electric complex one mile east of the proposed site, the Skinner Lake homes two miles east of the proposed site, and a supermarket, shopping center and mobile home park south of the proposed site. *Id.*

[64]*Id.*

[65]600 F.2d 91 (7th Cir. 1979).

establishment of a branch bank. The appellant contended the proposed location of the branch was not a town within the meaning of the Indiana bank branching statute. The proposed location of the branch, one-eighth of a mile north of the corporate boundaries of Winamac, Indiana,[66] was unincorporated and nameless.[67] It contained twenty-five houses and had an approximate population of thirty-eight, including eight minors.[68] The only businesses within one-half mile of the site which were not within the corporate boundaries of Winamac were a nursery one-quarter mile to the north of the site,[69] a veterinary clinic one-quarter mile north of the nursery,[70] a farm supply store one-half mile north of the site,[71] and a cattle lot immediately north of the supply store.[72]

Relying on *First National*, *Pendleton*, and *Albion* as authority, the court concluded:

> "[T]own" denotes an area which serves to some extent as a hub for surrounding communities, that is, a population and commercial center. Thus, it need not be incorporated or have a name . . . but it at least should have a separate identity. From its use of this term, it is apparent that the Indiana legislature intended to impose a general minimum standard for the type of community that it believed could support a branch facility.[73]

The court decided that the Indiana legislature was imposing qualitative, rather than quantitative, restrictions upon a proposed branch site to determine if the site could support a branch.[74] These restrictions could be overcome by finding that the proposed branch site in the unincorporated area was an identifiable and separate community from the nearby town; a center for business, social, and educational activity; or a nucleus for new business establishments.[75] The court concluded that the area in issue could not constitute a "town":

> Neither the tiny population nor the small and specialized commercial community, however, [could] attract sufficient traffic from surrounding areas to warrant a finding that the site serves as a hub for the surrounding area, or, more

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[66] *Id.* at 94.
[67] *Id.* at 95.
[68] *Id.*
[69] *Id.* at 94.
[70] *Id.*
[71] *Id.* at 94-95.
[72] *Id.* at 95.
[73] *Id.* at 96.
[74] *Id.*
[75] *Id.* at 97.

specifically, a finding that the area [could] provide any support for a full-service branch facility.[76]

Heimann endorses the principle that each determination of whether an unincorporated area is a "town" for purposes of the Indiana bank branching statute must be decided upon its own set of facts. The cases suggest the need for an "attraction" within a compact area between the residences and businesses located in the area surrounding the proposed location of the branch. A finding by the Department or the courts that the compact area has a distinct identity, marked by a degree of cohesiveness between its residences and a dependency between the residents and the local businesses is a prerequisite to the Department or the courts concluding that the unincorporated area is a "town" within the meaning of the Indiana branching statute.

By focusing upon the economic factors of the proposed branch site and not upon artificial political boundaries, Indiana courts are adopting a policy which is more concerned with increasing benefits and services to area customers and less concerned with protecting an existing bank's market. This judicial emphasis upon a bank's service area and not artificial boundaries should allow branches to be established in locations that will allow banks to offer more convenient and efficient banking services to the public.

III. Home Office Protection

The Indiana branching statute provides an existing bank, but not a branch bank, with "home office protection." This statute allows a branch to be established only when "there is no bank or trust company located in the city or town in which it is proposed to establish such branch bank," unless the proposed location is within the city or town within which the home office of the applicant bank is located.[77] Neither the legislature nor the courts have offered a reason for this provision. The Supreme Court of New Jersey, however, has stated a reason for the New Jersey home office protection provision.[78] The New Jersey court explained that this provision gave preference to local interests because a bank is generally organized by local people responding to a local need for additional banking alternatives. The home office protection provision is designed to favor these local interests as against non-local interests seeking

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[76]*Id.*

[77]Ind. Code § 28-1-17-1 (1976).

[78]Montclair Nat'l Bank and Trust Co. v. Howell, 32 N.J. 29, 159 A.2d 113 (1960).

[79]*Id.* at 46-47, 159 A.2d at 122.

to establish a branch in the area thereby taking advantage of the local need.[80]

Such a policy, while favoring local *banking* interests, may nevertheless be detrimental to the *public* interest. By shielding local banks from outside competition, the public may suffer due to lower interest rates on savings accounts, decreased availability of credit, higher interest rates on loans, and shorter hours. Such a result benefits only one group, the owners of the local bank. Apparently realizing the questionable value of this policy, courts have narrowly applied the home office protection provision.[81]

The 1953 Attorney General's opinion is the first indication in Indiana of dissatisfaction with the policy. The Indiana Attorney General stated that the statute should be strictly construed and the individual bank accused of violating the home protection provision should be favored over the statute whenever an ambiguity arose. The criminal sanction for violating the statute and the restrictive nature of the statute were the reasons given in the opinion for such a conclusion.[82]

Indiana courts have also narrowly construed the home office protection language.[83] *First National Bank* involved the issue whether "city or town" referred to the "economic city" for home office protection purposes.[84] The court dealt with this issue in a summary fashion. Because home office protection was a restriction upon the right of a bank to establish a branch, the court decided that its terms should be construed narrowly,[85] thereby limiting "city or town" in this context to the political and not economic "city or town."

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[80]*Id.* at 47, 159 A.2d at 122.

[81]The Indiana legislature has also taken steps to remove some aspects of home office protection. The Indiana branching law was amended in 1971 and the following protection afforded a bank's home office was deleted: "No branch bank may hereafter be established or located within one-quarter mile of another bank or trust company, nor at any location which will jeopardize the welfare of another bank or trust company already established in the city or town." An Act to amend Title 28, article 1 of the Indiana Code of 1971 Concerning Financial Institutions, Pub. L. No. 394, § 30 (codified at IND. CODE § 28-1-17-1 (1976)).

[82][1953] OP. IND. ATT'Y GEN. at 154.

[83]The result-oriented approach utilized by the courts has created a gross inconsistency in the construction of the words "city or town" as used in the Indiana branching statute. The courts narrowly construe the same term when determining if an unincorporated area is a city or town. 342 F. Supp. at 877. This inconsistency is irremediable unless the legislature repeals the home office provision or the judiciary retreats to a less competitive and therefore less efficient position by applying a single, strict definition to "city or town" for purposes of locating a branch bank and providing home office protection.

[84]342 F. Supp. at 877.

[85]*Id.*

The court reasoned further that the criminal penalties imposed for violating the branching statute[86] dictated a narrow construction of the home office provision.[87] The court stated that an anomaly would result if a bank could be penalized under the above statute for establishing a branch pursuant to authorization by the proper banking regulation authorities.[88] Such a result could be reached, however, if a court held that the branch location was within the economic city or town, although located outside the corporate boundaries. To prevent this dilemma, the court explained the need to identify precisely the area within the sweep of home office protection.[89] Therefore, the court concluded that the words "city or town" in the home office protection provision should be read as the incorporated city or town and not the economic city or town.[90]

The Indiana Supreme Court in *Pendleton*[91] also construed the home office provision narrowly. Faced with the contention that an area outside the corporate limits of Pendleton should be considered a part of the town for home office protection purposes, the court held that the area was a "town." The one-half mile distance and the clear demarcation shown by aerial photographs between the two communities, plus Huntsville's existence beyond Pendleton's corporate borders, was sufficient evidence to support the trial court's finding that Huntsville was a community separate from Pendleton.[92] Although the court never stated that the statute should be limited by a narrow interpretation, its narrow application of the statute certainly implies a narrow construction.

An interesting situation occurred in Michigan which could conceivably occur in Indiana. In *Bank of Dearborn*,[93] the Michigan Supreme Court was faced with a situation in which the bank claiming home office protection was located in an unincorporated area. The bank, claiming protection, appealed a decision that its location and the site of the competitor bank's proposed branch were in two separate unincorporated villages. The appellant contended that the area in which the two sites were located was continuous and homogeneous without physical or geographic dividing lines and that therefore the two sites were in the same village. The court rejected

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[86]IND. CODE § 28-1-17-3 (1971). This section was amended in 1978, but still provides that any person violating IND. CODE § 28-1-17-1 shall be guilty of a misdemeanor. *See* IND. CODE § 28-1-17-3 (Supp. 1979).

[87]342 F. Supp. at 877-78.

[88]*Id.*

[89]*Id.* at 877.

[90]*Id.* at 878.

[91]257 Ind. at 363, 274 N.E.2d at 705.

[92]*Id.* at 368-69, 274 N.E.2d at 709.

[93]365 Mich. 567, 114 N.W.2d 210 (1962).

this argument, noting that each of the two areas met the Michigan definition of village, which focused on economic factors.[94] If the court had agreed with the appellant that continuity and homogeneity were restrictive factors, then it is conceivable, as the court noted, that large unincorporated suburban areas could be deprived of close and convenient banking facilities, in direct contravention of the public interest.

Because a new bank may be established in an unincorporated area in Indiana,[95] the situation in *Bank of Dearborn* might occur in this state. However, given the judicial disposition in Indiana to narrowly construe the home office protection provision, the Indiana courts are likely to decide that the two locations are in different towns if the proposed branch location could qualify as a town without including too much of the established bank's "territory." Also, the courts' reluctance to apply the criminal sanctions of the Indiana branching statute in narrowly construing the home office protection provision[96] provides an adequate basis for refusing to allow a bank which established its home office in an unincorporated area to claim the benefits of home office protection.

In short, the Indiana courts, restrained by a statutory home office provision which restricts banking for the apparent benefit of the local *banking* interest at the expense of the local *public* interest, have admirably limited this provision to its narrowest terms to improve efficiency. There is little left for the judiciary to do in this area. The ultimate solution rests with the legislature which may repeal the provision, thereby increasing bank efficiency and convenience.

IV. Public Convenience and Advantage

Prior to the approval of any branch bank application, the Department of Financial Institutions must find that the proposed branch will subserve and promote the "public convenience and advantage."[97] "Public convenience and advantage" is not defined in the bank branching statute. Consequently, the courts have construed the term. As with other statutory terms, the Indiana courts have used their powers of construction and interpretation to encourage greater efficiency in the Indiana banking industry.

The only case in Indiana analyzing the meaning of "public convenience and advantage" is *Department of Financial Institutions*

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[94]*Id.* at 571-73, 114 N.W.2d at 212-13. *See* text accompanying notes 33-35 *supra.*

[95][1959] Op. Ind. Att'y Gen. 119, 123-24.

[96]*See* First Nat'l Bank v. Camp, 342 F. Supp. 871 (N.D. Ind. 1971), *aff'd*, 463 F.2d 595 (7th Cir. 1972).

[97]Ind. Code § 28-1-17-1 (1976).

v. Wayne Bank and Trust Co.[98] *Wayne Bank* represents a clear attempt by the Indiana courts to increase the number of branch banks by adopting a pragmatic test of determining whether a branch promotes "public convenience and advantage" without creating a threat to its customers. In applying this test, the court discussed the virtues of permitting more competition in the banking industry.

The case involved an appeal by the Department of Financial Institutions, of the trial court's decision vacating the Department's order disapproving Wayne Bank's branch application and remanding the case back to the Department. The Indiana Court of Appeals affirmed the trial court.[99] The court of appeals stated that the Department based its denial of the branch application solely upon the basis that the existing Richmond banks were providing adequate service to the people in the area to be served by the proposed Wayne Bank branch,[100] and therefore the proposed branch would not promote the "public convenience and advantage." The court held, however, that the record revealed that all of the evidence "point[ed] to the fact that the public convenience and advantage would be served by the establishment of a branch of Wayne Bank in Spring Grove."[101] The court decided that Wayne Bank posed no threat of imprudent banking practices because it was adequately captialized and well-managed.[102] The court also held that the existence of competitor banks, having appropriately located facilities and providing adequate and sufficient banking services, was an insufficient basis upon which to refuse to approve a branch application.[103] This holding is, however, subject to the condition that the economy and potential of the area are adequate to support another bank without resulting in excessive competition and danger to existing banks and the banking structure at large.[104]

The court of appeals also held that the public need or interest in a branch would be furthered when a branch proposes to pay higher rates or offer greater services or advantages to customers than are presently being offered.[105] Moreover, the court found that "the only

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[98]381 N.E.2d 1100, 1105-07 (Ind. Ct. App. 1978), *rehearing denied*, 385 N.E.2d 482 (Ind. Ct. App. 1979), *transfer denied*, No. 1-1277 A 303 (Ind. Ct. App. June 27, 1979) (70 Ind. Dec. No. 2, vii).

[99]381 N.E.2d at 1107.

[100]*Id.* at 1105.

[101]*Id.* at 1106.

[102]*Id.*

[103]*Id.* at 1105.

[104]*Id.* (citing Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n, 329 F. Supp. 1331 (S.D. Ohio 1971); Goldy v. Gerber, 151 Colo. 180, 377 P.2d 111 (1962); Montclair Nat'l Bank and Trust Co. v. Howell, 32 N.J. 29, 159 A.2d 113 (1960); Chimney Rock Nat'l Bank v. State Bank Bd., 376 S.W.2d 595 (Tex. Civ. App. 1964)).

[105]381 N.E.2d at 1106.

interest which would be served in excluding a bank which offers higher interest on deposits, lower interest on certain loans, and longer banking hours is that of the Richmond banks, not that of the people in the proposed service area."[106]

Discussing the advantages of promoting competition by increasing bank branches, the court explained that the Department's purpose is not to protect nor create monopolistic situations.[107] The Department's purpose, according to the court, is to protect the public from imprudent banking practices.[108] The court, however, did not totally negate competition's effect upon an existing bank. Competition should be a predominant factor in considering a branch application, but only when the effect of the competition would create the possibility of an existing bank collapsing or its business being severely damaged.[109] In that situation, competition's effect must be considered controlling; the collapse or severe damage of an existing bank would prove detrimental to the public convenience and advantage.[110] A collapse or near collapse of a bank would shake public confidence in the banking industry and perhaps result in runs on healthy banks. The court decided that minor losses of bank business resulting from competition were not controlling factors in determining whether to permit a branch to be established in an area served by an existing bank.[111]

The court also rejected any contention that banks have some right to be free from competition, unless statutory protection from this competition is provided. Quoting the trial court, the court of appeals found: "Competition is the life blood of a free enterprise economic system, and competition serves both the convenience and needs of the public. Banks have no right to be free of competition except as otherwise provided by statute."[112]

Rejecting a subsequent request for rehearing in the *Wayne Bank* case,[113] the court of appeals distinguished between "public con-

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[106]*Id. See also* First Nat'l Bank v. Camp, 471 F.2d 1322 (5th Cir. 1973); Grenada Bank v. Watson, 361 F. Supp. 728 (N.D. Miss. 1973); Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n, 329 F. Supp. 1331 (S.D. Ohio 1971); Ciety v. Green, 300 A.2d 227 (Del. Super. Ct. 1972); *In re* Howard Sav. Inst. v. Howell, 32 N.J. 29, 159 A.2d 113 (1960); Gerst v. Cain, 388 S.W.2d 168 (Tex. 1965).

[107]381 N.E.2d at 1106.

[106]*Id.*

[109]*Id.* at 1107.

[110]*Id.*

[111]*Id.*

[112]*Id.* The trial court relied on the following cases:
Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n, 329 F. Supp. 1331 (S.D. Ohio 1971); Hoosier State Bank v. Saxon, 248 F. Supp. 233 (N.D. Ind. 1965); First Fed. Sav. and Loan Ass'n v. Department of Banking, 188 Neb. 215, 196 N.W.2d 105 (1972); Gerst v. Cain, 388 S.W.2d 168 (Tex. 1965).

[113]385 N.E.2d 482 (Ind. Ct. App. 1979).

venience and advantage" and "public necessity." The Department contended that a conflict existed between the court's original opinion in *Wayne Bank*[114] and another decision rendered by the court in the same year.[115] The Department argued that the court of appeals incorrectly considered only the competitive situation in determining whether the public convenience and advantage would be promoted and subserved. The Department relied on *Department of Financial Institutions v. Colonial Bank and Trust Co.*,[116] in which it was held that it was improper for the trial court to make a determination whether a proposed new bank would be a "public necessity" solely upon the competitive impact of the proposed new bank.[117]

Although the court of appeals in *Wayne Bank* ruled it had considered more than the effect of competition in its original opinion,[118] it distinguished the original *Wayne Bank* decision from the one in *Colonial Bank*. The most obvious distinction was the governing statutes in each case. The applicable statute in *Colonial Bank* required a finding of "public necessity" before a *new bank* could be established.[119] The governing statute in *Wayne Bank*, however, required a finding of "public convenience and advantage" before a branch bank could be established.[120] The court concluded that the use of the different terms in the two statutes was not an unnoticed or unplanned result of legislative action.[121] The court reasoned that

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[114]381 N.E.2d 1100 (Ind. Ct. App. 1978).

[115]Department of Financial Insts. v. Colonial Bank & Trust Co., 375 N.E.2d 285 (Ind. Ct. App. 1978), *cert. denied*, 439 U.S. 1116 (1979).

[116]*Id.*

[117]*Colonial Bank and Trust Co.* dealt with the establishment of a new bank as opposed to a branch. Consequently, the standard required was not "public convenience and advantage" but rather "public necessity." IND. CODE § 28-1-2-26 (1976). The statute for establishing a new bank, provides:

> Proposed financial institution; investigation. Upon the filing of such application, the department shall make, or cause to be made, a careful investigation and examination relative to the financial standing and character of the incorporators or organizers, the character, and qualifications and experience of the officers of the proposed financial institution, of the *public necessity* for the financial institution in the community in which such proposed financial institution is to be established, and, if the institution is to be a bank or trust company, of the adequacy of the proposed capital thereof; and if the members of the department, after the hearing, as hereinbefore provided, shall determine either of such questions unfavorably to such applicants, the application shall not be approved, and if all such questions be determined favorably, the application shall be approved.

Id. (emphasis added).

[118]385 N.E.2d at 484 (quoting Department of Financial Insts. v. Wayne Bank & Trust Co., 381 N.E.2d 1100, 1106-07 (Ind. Ct. App. 1978)).

[119]385 N.E.2d at 484; IND. CODE § 28-1-2-26 (1976).

[120]385 N.E.2d at 484; IND. CODE § 28-1-17-1 (1976).

[121]385 N.E.2d at 485.

the legislature must have used dissimilar terminology because it intended the standard to be "separate and distinct."[122] The literal meaning of the words of the two standards also supported the court's contention. "'Convenience and advantage' denotes something less compelling than 'necessity.'"[123] Consequently, the competitive effect would be of less importance in considering the application for a branch bank than in considering the application for a new bank, although the effect of competition from the proposed branch would become a controlling factor in considering a branch application if the effect of the proposed branch would be to severely damage or cause the possible collapse of an existing bank.[124]

As the above discussion and analysis of "public convenience and advantage" demonstrates, the courts have taken significant steps to promote a more efficient banking system. The public will not be precluded from enjoying another banking alternative merely because existing institutions are providing adequate service, especially if the proposed branch intends to offer greater advantages to the public than are offered by the existing banks. Nor will a proposed branch be hampered by showing that it will promote the "public convenience and advantage" merely in the political subdivision within which it is located. Instead, the courts will see if the proposed branch will subserve the "public convenience and advantage" of its "economic city" or service area. The major shift toward a more efficient economic banking system is demonstrated by the language in *Wayne Bank* recognizing the value of competition in promoting the "public convenience and advantage." The courts are given greater flexibility to promote greater efficiency in the area of branch banking than in the area of new banks. Such a result, however, is necessary; new banks incur a greater risk of failure than a branch bank does, due to the new bank's lack of economies of scale. Branch banks possess more economies because the main office bears a predominant share of banking overhead expenses. Indeed, there is an inherent safety factor in the branch banks' economies of scale which makes the chance of a branch bank failure more remote than the chance of a new bank collapse.

IV. Conclusion

The courts applying Indiana bank branching law have moved the Indiana banking industry toward a more competitive and theoreti-

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[122] *Id.*
[123] *Id.*
[124] *Id.*

cally more efficient banking system.[125] The courts have discarded the old notions that competition is harmful *per se* in the banking field and have allowed banks to more actively compete.[126] This policy favoring competition has benefited consumers in the form of lower interest rates, longer hours, and greater services. This trend conforms with the principle that banking should be regulated to protect the *public interest* and not the *private interest* of the banks.

JOHN W. TRANSELLE

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[125]Some commentators have argued that the banking industry should be regulated under the antitrust laws as any other industry. *See* Baker, *Bank Expansion: Geographic Barriers*, 91 BANKING L.J. 707 (1974). This belief in the antitrust laws is founded upon views similar to those held by Mr. Justice Black:

> [The Sherman Act] rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.

Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1958).

[126]The United States Court of Appeals for the Seventh Circuit rendered a decision on April 23, 1980, which appears to be directly opposed to the current judicial trend in Indiana regarding bank branching. In State Bank of Rensselaer v. Heimann, 619 F.2d 679 (7th Cir. 1980), the Seventh Circuit reversed a decision of the Comptroller of the Currency authorizing the establishment of a branch.

The court stated that the proposed site was not a "town" within the meaning of the branching statute, although located approximately 1,000 feet south of St. Joseph's College in an unincorporated area appearing on maps as "Collegeville." Expressing serious doubts whether a campus fit the definition of town, the court stated that since the intent of the applicant bank was to open a branch to serve the incorporated town of Rensselaer, this attempt to "circumvent" the branching laws could not be allowed. This reasoning by the court is diametrically opposed to the Indiana decisions narrowly contruing the home office protection provision.

In addition, the court ignored the language in *Wayne Bank* favoring healthy competition among banks. The Seventh Circuit held that Indiana allowed branches in areas not already served but did not allow branches to be used as a means of stimulating competition among banks.

Although a strong argument can be made that education is a business and Collegeville is a town within the meaning of the statute, the most disturbing aspect of the Seventh Circuit's decision is that the court has apparently decided to ignore Indiana decisions which narrowly construe home office protection, liberally construe town, and generally favor competition as a means of subserving and promoting the public convenience and advantage.

Case Note

Navigational Servitude—TAKING OF PROPERTY UNDER THE FIFTH AMENDMENT—Grant of public access to a body of water made navigable by artificial means held to be a taking of private property for public use requiring just compensation. *Kaiser Aetna v. United States*, 444 U.S. 164 (1979).

A navigable river is "any river with enough water in it to float a Supreme Court opinion."[1]

At common law, the public right of access to navigable waters was two-fold: the public right of navigation in waters that were navigable in fact and the public right of fishing in waters that were subject to the ebb and flow of the tide.[2] Dominion over bodies of water in the United States was unsettled until 1842 when the Supreme Court in *Martin v. Waddell*[3] declared that navigable waters and the land under them were held prior to the American Revolution by the King as a public trust and that after the Revolution the people of each state held "the absolute right to all their navigable waters and the soils under them for their own common use."[4] This doctrine of sovereign dominion precluded private ownership of navigable waters and the submerged beds under them and gave title to the individual states.[5]

Federal power over navigable waters depends entirely upon congressional authority under the commerce clause and not upon federal title to the water or the land below. *Gibbons v. Ogden*[6] first established that navigation is a part of interstate commerce.[7] Subsequent cases confirmed that congressional control over navigable waters is as broad as the commerce clause[8] and that no private prop-

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[1]C. MEYERS & A. TARLOCK, WATER RESOURCES MANAGEMENT 240 (1941), *quoted in* United States v. Kaiser Aetna, 408 F. Supp. 42, 49 (D. Hawaii 1976), *rev'd*, 584 F.2d 378 (9th Cir. 1978), *rev'd*, 444 U.S. 164 (1979).

[2]Reece v. Miller, 8 Q.B.D. 626 (1882); Murphy v. Ryan, 2 Ir. C.L.R. 143 (1868). *See* MacGrady, *The Navigability Concept in the Civil and Common Law: Historical Development, Current Importance, and Some Doctrines That Don't Hold Water*, 3 FLA. ST. U.L. REV. 513, 584-87 (1975).

[3]41 U.S. (16 Pet.) 366 (1842).

[4]*Id.* at 410.

[5]Congress ratified this judicial construction in 1953 by passage of the Submerged Lands Act, which gave to the respective states unqualified title to lands beneath navigable waters. Pub. L. No. 31, 67 Stat. 30 (codified at 43 U.S.C. § 1311 (1976)).

[6]22 U.S. (9 Wheat.) 1 (1824).

[7]*Id.* at 190.

[8]United States v. Twin City Power Co., 350 U.S. 222, 224 (1956); United States v.

erty rights exist in the waters themselves.[9] In *United States v. Twin City Power Co.*,[10] the Supreme Court summarized federal power over property rights in these broad terms:

> The interest of the United States in the flow of a navigable stream originates in the Commerce Clause. That clause speaks in terms of power, not of property. But the power is a dominant one which can be asserted to the exclusion of any competing or conflicting one. The power is a privilege which we have called "a dominant servitude." . . .
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> . . . .
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> It is no answer to say that these private owners had interests in the water that were recognized by state law. We deal here with the federal domain, an area which Congress can completely pre-empt, leaving no vested private claims that constitute "private property" within the meaning of the Fifth Amendment.[11]

Contrary to the apparently well-established principle stated in *Twin City Power* that federal power over navigation is exclusive, the Supreme Court has recently recognized for the first time a private property interest in a navigable body of water. In *Kaiser Aetna v. United States*,[12] the public right of access amounted to a taking of property requiring reasonable compensation under the fifth amendment.[13]

Kaiser Aetna involved a body of water, Kuapa Pond, that became navigable by virtue of man-made development.[14] Although waters made navigable by artificial means have long been included in the sweep of federal power over navigation,[15] the fact that a

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Appalachian Elec. Power Co., 311 U.S. 377, 426 (1940); Zabel v. Tabb, 430 F.2d 199, 203 (5th Cir. 1970). *See* City of Tacoma v. Taxpayers, 357 U.S. 320, 334 (1958); City of Eufaula v. United States, 313 F.2d 745, 747 (5th Cir. 1963).

[9]United States v. Chandler-Dunbar Water Power Co., 229 U.S. 53 (1913). Holding that riparian owners have no property right in the water power inherent in the river, the Court stated: "[T]hat the running water in a great navigable stream is capable of private ownership is inconceivable." *Id.* at 69.

[10]350 U.S. 222 (1956).

[11]*Id.* at 224-25.

[12]444 U.S. 164 (1979).

[13]*Id.* at 180.

[14]There was evidence that the pond in *Kaiser Aetna* was navigable before improvement. The district court had found that "the Pacific tides ebbed and flowed over Kuapa Pond in its pre-marina state." United States v. Kaiser Aetna, 408 F. Supp. 42, 50 (D. Hawaii 1976), subsequent history *quoted in* Kaiser Aetna v. United States, 444 U.S. at 181-82 n.1 (Blackmun, J., dissenting). That tidal ebb and flow is a valid test of navigability is in dispute. *See* note 49 *infra*.

[15]*See* notes 52-54 *infra* and accompanying text.

private party had engaged in costly and extensive development may have been a crucial factor in the decision.[16] The history of the pond, summarized below, is essential to an understanding of the *Kaiser Aetna* opinion.

I. The History of Kuapa Pond

Kuapa Pond was a 523 acre lagoon in Oahu, Hawaii, adjacent to Maunalua Bay, a navigable body of water, and separated from the bay by a sand bar formed by natural accretions. Prior to 1961, it was used exclusively as a fishpond. Under the Hawaiian feudal system in existence until 1848, tribal chiefs who owned the fishponds allocated fishing rights to subchiefs, land agents, and vassals, subject always to the will of the chief. No public right to fish was recognized. During this period, the Hawaiians reinforced the sand bar separating Kuapa Pond from the bay with stone walls, into which they built sluice gates in order to use the tidal action for raising and catching fish.

Title to Kuapa Pond, presently vested in Bishop Estate, can be traced back to 1848 when, as part of a national land division known as the Great Mahele, King Kamehameha III distributed land and water units called "ahupuaas" to his subjects. In 1961, Kaiser Aetna leased the Kuapa Pond area from Bishop Estate for the purpose of building a housing development and constructing a marina. In addition to dredging and filling parts of the pond and erecting retaining walls and bridges, Kaiser Aetna also dredged an eight foot channel between Kuapa Pond and Maunalua Bay to allow boats from the marina access to the bay. Both residents and nonresidents of the Kaiser Aetna subdivision pay seventy-two dollars annually for the right to moor their boats in the marina and travel across Kuapa Pond into the bay.

Kaiser Aetna notified the Corps of Engineers of its plans in 1961, and again when it contemplated dredging a channel to the bay. The Corps at all times acquiesced. A letter from Kaiser Aetna stating that "[i]t is our understanding that no separate federal permit will be required for this construction, and that there will be no requirement for public use or control of any waters on the Kuapa Pond side of the bridge" was unanswered.[17]

In 1972 the Corps of Engineers declared Kuapa Pond to be navigable. Subsequently, the Corps petitioned the District Court of Hawaii for a declaratory judgment that Kaiser Aetna must obtain

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[16]The Court noted that petitioners had invested millions of dollars in the improvement. 444 U.S. at 169.

[17]United States v. Kaiser Aetna, 408 F. Supp. at 47 n.4.

permission pursuant to section 10 of the Rivers and Harbors Act[18] for any future construction in the marina and that the public has a right of public access to Kuapa Pond since it is now a navigable water of the United States.

In its defense, Kaiser Aetna denied that the pond was navigable and contended that a declaration of public navigability violated the fifth amendment prohibition against the taking of private property without compensation. The district court held that although Kuapa Pond had become navigable waters, the United States could not appropriate the pond for public use without compensation.[19] The Court of Appeals for the Ninth Circuit reversed, holding that the public had the right of navigational use of the waters.[20] The Supreme Court reversed the decision of the court of appeals and held that the imposition of navigational servitude upon Kuapa Pond required the invocation of eminent domain power and the payment of just compensation.[21]

Two significant facts emerge from the history of Kuapa Pond: The pond has always been private property under Hawaiian law,[22] and the pond was not navigable before its development into a marina.[23] These facts undoubtedly influenced the Court to recognize a compensable interest in navigable waters by restricting the ap-

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[18]33 U.S.C. § 403 (1976). Section 10 provides:

> The creation of any obstruction not affirmatively authorized by Congress, to the navigable capacity of any of the waters of the United States is prohibited; and it shall not be lawful to build or commence the building of any wharf, pier, dolphin, boom, weir, breakwater, bulkhead, jetty, or other structures in any port, roadstead, haven, harbor, canal, navigable river, or other water of the United States, outside established harbor lines, or where no harbor lines have been established, except on plans recommended by the Chief of Engineers and authorized by the Secretary of the Army; and it shall not be lawful to excavate or fill, or in any manner to alter or modify the course, location, condition, or capacity of, any port, roadstead, haven, harbor, canal, lake, harbor or refuge, or inclosure within the limits of any breakwater, or of the channel of any navigable water of the United States, unless the work has been recommended by the Chief of Engineers and authorized by the Secretary of the Army prior to beginning same.

[19]United States v. Kaiser Aetna, 408 F. Supp. at 54.

[20]United States v. Kaiser Aetna, 584 F.2d 378, 384 (9th Cir. 1978).

[21]444 U.S. at 180.

[22]United States v. Kaiser Aetna, 408 F. Supp. at 46. The district court noted that the Organic Act of 1900, ch. 339, § 95, 31 Stat. 160 (codified at 48 U.S.C. § 506 (1976)), had given the public free access to sea water fisheries, but that the Supreme Court had also recognized a property right in these fisheries. 408 F. Supp. at 51 (citing Damon v. Hawaii, 194 U.S. 154 (1904)). Fishponds are still subject to private ownership. 408 F. Supp. at 51. The court did not discuss whether navigable fishponds are susceptible to private property rights under Hawaiian law.

[23]*But see* United States v. Kaiser Aetna, 408 F. Supp. at 47; note 14 *supra*.

plication of the doctrine of navigational servitude, the doctrine which gives the government an absolute right of public access to navigable waters. In this decision, the Court has significantly altered the traditional concepts of navigational servitude, navigability, and taking, all of which prescribe congressional powers over American waters.

II. Navigational Servitude and the Commerce Clause

The nature of federal authority under the commerce clause was first described by Justice Marshall in *Gibbons v. Ogden*:[24] "It is the power to regulate; that is, to prescribe the rule by which commerce is to be governed. This power, like all others vested in congress, is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the constitution."[25] This recognition of plenary power in Congress, even in areas where Congress has not acted, helped to shape a national policy of fostering an environment for the free development of national trade and transportation unrestricted by state or private interests. As the country expanded and grew increasingly industrial, congressional power under the commerce clause seemed limitless.[26]

From the beginning, navigation has been subject to broad federal control. In *Gibbons v. Ogden*, Justice Marshall explained that navigation is central to the commerce clause power:

> All America understands, and has uniformly understood, the word "commerce," to comprehend navigation. It was so understood, and must have been so understood, when the Constitution was framed. The power over commerce, including navigation, was one of the primary objects for which the people of America adopted their government, and must have been contemplated in forming it. The convention must have used the word in that sense; because all have understood it in that sense; and the attempt to restrict it comes too late.[27]

The regulation of navigable waters as part of the federal control of interstate transportation has expanded to include watershed

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[24]22 U.S. (9 Wheat.) 1 (1824).

[25]*Id.* at 195.

[26]*See, e.g.*, Scarborough v. United States, 431 U.S. 563 (1977); United States v. Sullivan, 332 U.S. 689 (1948); United States v. Southeastern Underwriters Ass'n, 322 U.S. 533 (1944); Wickard v. Filburn, 317 U.S. 111 (1942).

[27]22 U.S. (9 Wheat.) at 190.

development, flood control, and the production of electric power.[28] For the exercise of federal authority, there need only be navigability,[29] and some link, however tenuous, to interstate commerce.[30]

Navigational servitude is a dominant federal easement over all navigable waters of the United States.[31] Similar to the common law right of public access to navigable waters, this right arose in the United States under the commerce clause as a national policy of maintaining navigable streams as "common highways . . . forever free."[32] During the judicial expansion of activities subject to regulation under the commerce clause, the term navigational servitude never lost its historic definition: the power to control navigation.

Although no one owns the water of a navigable stream, federal dominant servitude is a concept of property law. Prior to *Kaiser Aetna*, no taking could result when the servitude was exercised.

> It is not the broad constitutional power to regulate commerce, but rather the servitude derived from that power and narrower in scope, that frees the Government from liability in these cases. When the Government exercises this servitude, it is exercising its paramount power in the interest of navigation, rather than taking the private property of anyone.[33]

In *Kaiser Aetna*, the government contended that Kuapa Pond was a navigable water over which the public has a "federally protected right of navigation."[34] Although the Court conceded that Kuapa Pond was navigable, it refused to find a noncompensable

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[28]The authority of the government over navigation is "as broad as the needs of commerce." United States v. Appalachian Elec. Power Co., 311 U.S. 377, 426 (1940). *See* Ashwander v. Tennessee Valley Authority, 297 U.S. 288 (1936).

[29]*See* text accompanying notes 48-57 *infra*.

[30]Recreational use by out-of-state visitors of Lake Wawasee, an intrastate lake, was a sufficient link to interstate commerce in United States v. Byrd, 609 F.2d 1204 (7th Cir. 1979) (wetlands contiguous to lake subject to regulation as navigable waters under the commerce clause).

[31]United States v. Grand River Dam Auth., 363 U.S. 229, 231 (1960); United States v. Twin City Power Co., 350 U.S. 222, 225 (1956) (citing United States v. Gerlach Live Stock Co., 339 U.S. 725, 736 (1950)); Sherrill v. United States, 381 F.2d 744 (Ct. Cl. 1967). *See* Gibson v. United States, 166 U.S. 269, 271 (1897); Trelease, *Federal Limitations on State Water Law*, 10 BUFF. L. REV. 399, 407-08 (1961).

[32]Act of Aug. 7, 1789, ch. 8, 1 Stat. 50, at 51 n.(a) (Act providing for the governing of the Northwest Territory), *quoted in* Kaiser Aetna v. United States, 444 U.S. at 186 (Blackmun, J., dissenting).

[33]United States v. Kansas City Ins. Co., 339 U.S. 799, 808 (1950). *See generally* Bartke, *The Navigation Servitude and Just Compensation—Struggle for a Doctrine*, 48 ORE. L. REV. 1 (1968); Powell, *Just Compensation and the Navigation Power*, 31 WASH. L. REV. 271 (1956).

[34]444 U.S. at 170 (quoting Brief for the United States at 13).

public right of access based upon navigational servitude, preferring to rest its decision upon "more traditional Commerce Clause analysis."[35] Because any activity affecting commerce may be regulated under the commerce clause, the Court stated that governmental authority over water does not depend upon navigability.[36] In support, the Court quoted the following language from *United States v. Appalachian Power Co.*:[37] "[I]t cannot properly be said that the constitutional power of the United States over its waters is limited to control for navigation . . . . In truth the authority of the United States is the regulation of commerce on its waters. Navigability . . . is but a part of this whole."[38] The Court in *Appalachian Power* did not, however, assert that congressional power over *navigation* can be exercised in the absence of navigability. The Court merely stated that federal authority over waters is not limited to navigation; it may encompass a number of other activities, such as flood control and watershed development.[39]

Having thus stated that regulatory power is broader than, and not coextensive with, navigational servitude, the Court in *Kaiser Aetna* held that although the government may freely regulate Kuapa Pond in the interests of navigation or commerce,[40] the grant of a public right of access amounted to a taking.[41] The Court's conception of navigational servitude is a radical change from prior cases. Although the parameters of the servitude have never been explicitly defined,[42] the aspect of the servitude that has distinguished it from other powers under the commerce clause is that it may be exercised without compensation. Nevertheless, the Court stated that it "has never held that the navigational servitude creates a blanket exception to the Takings Clause."[43] Because

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[35]444 U.S. at 174.

[36]*Id.*

[37]311 U.S. 377 (1940).

[38]*Id.* at 426-27, *quoted in* Kaiser Aetna v. United States, 444 U.S. at 173.

[39]*Id.*

[40]444 U.S. at 174.

[41]*Id.* at 179-80.

[42]In United States v. Grand River Dam Auth., 363 U.S. 229 (1960), the government argued that the servitude extends also to nonnavigable waters. The Court did not reach that issue. *Id.* at 232. In his dissenting opinion in *Kaiser Aetna*, Justice Blackmun made the following statement regarding the limits of the servitude: "To sustain its holding . . . I believe that the Court must prove that the navigational servitude does not extend to waters that are clearly navigable and fully subject to use as a highway for interstate commerce." 444 U.S. at 185 (Blackmun, J., dissenting).

One commentator has noted that since the decision in *Appalachian Power* the government has won every case on the issue of navigability. Morreale, *Federal Power in Western Waters: The Navigation Power and the Rule of No Compensation*, 3 NAT. RESOURCES J. 1, 5 (1963). The author has discovered no cases since 1963 in which the government has lost on that issue.

[43]444 U.S. at 172.

navigational servitude has been by definition a taking without compensation, there seems to be no logical support for this statement.[44]

The Court did not, in fact, impose navigational servitude upon Kuapa Pond. Redefining the servitude to include only waters that are navigable in fact in their natural state, the Court held that creation of a right of public access was a regulation that amounted to a taking.[45] In summary, the Court said that waters may be regulated under the commerce clause regardless of navigability, but that a noncompensable public right of navigation only arises when the waters are, in fact, already public highways of commerce.

This retreat from previously firm ground seems to have been influenced by two factors in the case: That public access would result in a severe deprivation of Kaiser Aetna's economic rights,[46] and that the pond was made navigable by privately-funded investment.[47] In this respect, the decision is representative of the Court's renewed interest in the protection of economic and property rights. In any case, a definition of navigability, at least for purposes of navigational servitude, must now include a consideration of the extent of artificial improvements.

III. NAVIGABILITY

The Supreme Court first defined navigable waters in *The Daniel Ball*.[48] Rejecting the common law doctrine that navigable waters are those subject to the ebb and flow of the tide,[49] the court formulated a new definition:

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[44]The dissent concluded that the navigational servitude extends to privately enhanced waters such as Kuapa Pond, but it treated the matter of compensation as a separate question. *Id.* at 187 (Blackmun, J., dissenting). Compensation would never be required when the right being valued is access to the waters. *Id.* at 189-90. Both the majority and the dissenters occasionally use the term to mean something other than a right of access without compensation. After *Kaiser Aetna*, navigational servitude is open to various interpretations, including simply a right of government regulation.

[45]444 U.S. at 178.

[46]*Id.* at 178-79.

[47]*Id.* The Court's test for navigability did not include tidal ebb and flow. *See* note 14 *supra*. *See also* text accompanying notes 92-95 *infra*.

[48]77 U.S. (10 Wall.) 557 (1870).

[49]The Court rejected the ebb and flow test as unsuitable for rivers, noting that the doctrine arose in England, an island country. *Id.* at 563. Justice Blackmun made this distinction in his dissenting opinion in *Kaiser Aetna*. 444 U.S. at 182-83 (Blackmun, J., dissenting). The definition that prescribes the jurisdiction of the Corps of Engineers includes the ebb and flow standard:

> Navigable waters of the United States are those waters that are subject to the ebb and flow of the tide and/or are presently used, or have been used in the past, or may be susceptible for use to transport interstate or foreign

> Those rivers must be regarded as public navigable rivers in law which are navigable in fact. And they are navigable in fact when they are used, or are susceptible of being used, in their ordinary condition, as highways for commerce, over which trade and travel are or may be conducted in the customary modes of trade and travel on water.[50]

This definition has often been cited, and considerably expanded, in commerce clause, admiralty, and federal title cases.[51] In *United States v. Appalachian Power Co.*,[52] the Court construed the phrase "susceptible of being used" to mean available for navigational use in its improved as well as its natural state.[53] Congress may assert its power under the commerce clause even if the improvements are not complete but merely contemplated or possible.[54] Furthermore, a stream made nonnavigable in fact by an artificial obstruction is still navigable in law.[55] A landlocked body of water may also be navigable for purposes of commerce clause regulation[56] but not for admiralty jurisdiction.[57]

After *Kaiser Aetna*, the power of Congress to regulate waters that are navigable in fact is a separate issue from the imposition of navigational servitude. Although the Court conceded that Kuapa Pond is navigable, it is navigable only for purposes of regulation and not for purposes of navigational servitude because it was, in its natural state, "incapable of being used as a continuous highway for the purpose of navigation in interstate commerce."[58] Navigability thus depends, according to the Court, upon the purpose for which

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> commerce. A determination of navigability, once made, applies laterally over the entire surface of the waterbody, and is not extinguished by later actions or events which impede or destroy navigable capacity.

33 C.F.R. § 329.4 (1979).

[50]77 U.S. (10 Wall.) at 563. *See* The Monticello, 87 U.S. (20 Wall.) 430, 439 (1874).

[51]According to the *Kaiser Aetna* opinion, the definition of navigability depends upon the purpose of the definition. 444 U.S. at 171. The navigability concept arises in three types of cases: Those arising under admiralty jurisdiction, those arising under the commerce clause, and cases concerning title to submerged beds. For a comprehensive overview of the various definitions of navigability and their historical and modern application, *see* MacGrady, *supra* note 2. *See generally* Laurent, *Judicial Criteria of Navigability in Federal Cases*, 1953 WIS. L. REV. 8.

[52]311 U.S. 377 (1940).

[53]*Id.* at 407. *Cf. Ex parte* Boyer, 109 U.S. 629 (1884) (wholly artificial canal subject to federal admiralty jurisdiction).

[54]311 U.S. at 407.

[55]Economy Light & Power Co. v. United States, 256 U.S. 113, 118 (1921).

[56]United States v. Byrd, 609 F.2d 1204 (7th Cir. 1979). *See* note 30 *supra*.

[57]The Daniel Ball, 77 U.S. (10 Wall.) 557 (1870); Oseredzuk v. Warner Co., 354 F. Supp. 453 (E.D. Pa. 1972); Shogry v. Lewis, 225 F. Supp. 741 (W.D. Pa. 1964).

[58]444 U.S. at 178. *But see* United States v. Appalachian Elec. Power Co., 311 U.S. 377 (1940).

the term is used,[59] and not upon the actual condition, or current use, of the waters. In this instance, however, the Court does not directly address the purpose for which the definition is invoked, but rather the circumstances under which navigability arose, that is, substantial private investment that converted the pond into an interstate seaway.[60]

In his dissent, Justice Blackmun defined the purpose of the servitude as protection of navigation in interstate commerce:

> The Court [has previously] recognized that what is at issue is a matter of power, not of property. The servitude, in order to safeguard the Federal Government's paramount control over waters used in interstate commerce, limits the power of the States to create conflicting interests based on local law. That control does not depend on the form of the water body or the manner in which it was created, but on the fact of navigability and the corresponding commercial significance the waterway attains. Wherever that commerce can occur, be it Kuapa Pond or Honolulu Harbor, the navigational servitude must extend.[61]

Significantly, Justice Blackmun did not entirely reject the notion that imposition of the servitude may include the right to compensation. Applying a balancing test of public and private interests, Justice Blackmun concluded that whenever the value to the private party is access to, or use of, navigable waters, the value is noncompensable.[62] This view closely conforms to the original purpose of government control over waters—protection of freedom of movement over interstate waters.

The majority opinion introduces into the area of navigation cases what Justice Blackmun termed "new legal uncertainty."[63] Whenever the government wishes to acquire public access to waters in the future, it must now consider whether the water was naturally navigable, to what extent artificial improvements aided in its navigability, and, possibly, whether the size of private investment requires that the government interference be considered a taking.

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[59]444 U.S. at 170-71.

[60]This fact was deplored by Justice Blackmun in the dissenting opinion: "The Court's opinion also embraces, distressingly for me, an implication that the *amount* of the private investment somehow influences the legal result. . . . I would think that the consequences would be the same whether the developer invested $100 or, as the Court stresses, . . . 'millions of dollars.' " *Id.* at 183-84 n.2 (Blackmun, J., dissenting).

[61]*Id.* at 187.

[62]*Id.* at 190.

[63]*Id.* at 191.

IV. The Taking Issue in *Kaiser Aetna*

Prior to *Kaiser Aetna*, the Supreme Court had never recognized a compensable property interest in navigable waters. In *United States v. Chandler-Dunbar Water Power Co.*,[64] the Court denied compensation for the water power inherent in the flow of a stream, stating that "[t]he requirement of the fifth amendment is satisfied when the owner is paid for what is taken from him. The question is what has the owner lost, and not what has the taker gained."[65] Title to the riverbed as well as the bank gave the owner no ownership rights in the river.[66] Having no title to the waters themselves, the owner had lost nothing. Again in *United States v. Appalachian Electric Power Co.*,[67] the Court reiterated that there are no private property rights in a navigable stream, stating that the flow of a stream has no "assessable value to the riparian owner."[68]

In cases involving condemnation of fast lands, the standard for compensable damages is generally the same standard announced in *Chandler-Dunbar*. The owner must be paid for what he has lost, but he cannot be paid for a property interest he never had. As the Court explained in *United States v. Rands*,[69] navigational servitude stops at the high-water mark. Therefore, the riparian owner has no compensable interest in access to a navigable stream or in its location as a port site or a power site.[70] Although the government is required to pay the fair market value for condemned fast lands, it has never been required to pay for those benefits that accrue by reason of the land's proximity to a navigable stream.[71]

The facts of *Kaiser Aetna* are, as the Court noted, quite different from riparian condemnation cases,[72] yet the Court awarded damages according to the standard used in these cases—compensation for what the owner has lost. The difference is that in *Kaiser*

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[64]229 U.S. 53 (1913).

[65]*Id.* at 76 (quoting Boston Chamber of Commerce v. Boston, 217 U.S. 189, 194-95 (1909)).

[66]229 U.S. at 69.

[67]311 U.S. 377 (1940).

[68]*Id.* at 424. The Court rejected the petitioner's constitutional challenge to section 14 of the Water Power Act of 1920, ch. 285, 41 Stat. 1071, *as amended by* Public Utility Holding Company Act of 1935, ch. 687, § 207, 49 Stat. 844 (current version at 16 U.S.C. § 807(a) (1976)), which provides that at the expiration of the license, the government may acquire and operate the project by paying the licensee's net investment. The Court stated that the provision was not a taking of property without due process. 311 U.S. at 427-28.

[69]389 U.S. 121 (1967).

[70]*Id.* at 123.

[71]*Id.* at 123-24 (citing United States v. Virginia Elec. & Power Co., 365 U.S. 624, 629 (1961); United States v. Twin City Power Co., 350 U.S. 222, 226 (1956)).

[72]444 U.S. at 176.

Aetna what the owner had lost was a state-created, private interest in an aquatic development: "[A]s previously noted, Kuapa Pond has always been considered to be private property under Hawaiian law. Thus, the interest of petitioners in the now dredged marina is strikingly similar to that of owners of fast land adjacent to navigable water."[73]

The Supreme Court has never formulated specific standards for what constitutes a taking requiring compensation under the fifth amendment. In *Penn Central Transportation Co. v. New York City*,[74] the Court surveyed prior cases that had addressed the taking issue, characterizing these cases as "essentially ad hoc, factual inquiries" dependent upon the circumstances in each case.[75] The inquiry is a balancing test, balancing the character and purpose of the government action against the extent and nature of the interference with private property rights.[76] In measuring the extent of governmental interference, the Court will consider the economic impact upon the property, particularly if there is a frustration of "distinct, investment-backed expectations."[77] If the government action serves a "substantial public purpose," however, there is likely to be no taking despite severe diminution or even destruction of property values.[78] On the other hand, actual physical invasion of private property is generally held to be a taking.[79]

In order to find a taking, the Court must find a property interest that has been interfered with. The Court in *Penn Central* stated that the interest must be "sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes."[80] In support of this statement, the Court cited *United States v. Willow River Power Co.*[81] and *United*

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[73]*Id.* at 179. The striking similarity that the Court finds between an interest in fast lands and Kaiser Aetna's interest in the marina is apparently based upon traditional Hawaiian property law. *See id.* at 191-92 (Blackmun, J., dissenting); text accompanying notes 84-86 *infra*.

[74]438 U.S. 104 (1978).

[75]*Id.* at 124.

[76]*Id.* at 130-31.

[77]*Id.* at 124 (citing Goldblatt v. Hempstead, 369 U.S. 590, 594 (1962)).

[78]*Id.* at 125-27.

[79]*Id.* at 128 (citing Griggs v. Allegheny County, 369 U.S. 84 (1962); United States v. Causby, 328 U.S. 256 (1946); Portsmouth Harbor Land & Hotel Co. v. United States, 260 U.S. 327 (1922); United States v. Cress, 243 U.S. 316 (1917)).

[80]438 U.S. at 125. The Court rejected the owner's argument that denial of the right to build a multi-story office building on top of Grand Central Terminal destroyed a valuable property interest—the right to profitable use of the airspace above the terminal. Balancing the interest that the owner retained, the right to use the terminal as a terminal, against the governmental interest, promotion of the general welfare, the Court concluded that no taking had occurred. *Id.* at 138.

[81]324 U.S. 499 (1945).

States v. Chandler-Dunbar Water Power Co.[82] for the proposition that no property interests exist in navigable waters.[83]

To reach the contrary result in *Kaiser Aetna*, the Court took into account several factors that it had not heretofore considered relevant to a definition of property interests. For the first time, the Court looked to state law. Noting that Kuapa Pond had always been private property under state law, the Court held that the pond was a private marina, the ownership interest of which was comparable to an interest in fast lands riparian to navigable waters.[84] In this respect, the Court may have been influenced by the district court's emphasis upon traditional private property rights in fishponds and seawater fisheries, rights which existed long before the annexation of Hawaii. The district court noted, for example, that the Supreme Court had previously recognized private ownership rights in Hawaiian sea fisheries.[85] The district court also distinguished between land obtained from foreign countries that recognized public rights in navigable waters, and lands in which, prior to annexation, the government had recognized private interests in certain waters:

> There is nothing inconsistent between the Hawaiian law of private ownership of fishponds and the federal power over navigation because the latter was merely a surrender of jurisdiction by the states of powers inherited from the Crown . . . — only to the extent the states had jurisdiction over waters to surrender.[86]

Regarding the private property issue, the precedential value of *Kaiser Aetna* depends upon subsequent interpretation. If the opinion was based upon a recognition of what the district court described as "peculiar rights arising out of Hawaii's unique feudal system of property rights,"[87] the decision is of limited applicability. If, on the other hand, the decision is an acknowledgment that federal navigational servitude is secondary to state-recognized property interests,[88] it is an obvious change in judicial recognition of ownership rights in navigable waters, affecting those owners who have title to lands adjacent to, or submerged beneath, bodies of water.

The Court also found that the owner's private rights were enhanced by the acquiesence of the Corps of Engineers in the dredging and improvement of the pond, leading to "a number of expectan-

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[82]229 U.S. 53 (1913).

[83]438 U.S. at 125.

[84]444 U.S. at 179.

[85]408 F. Supp. at 51 (citing Damon v. Hawaii, 194 U.S. 154 (1904)).

[86]*Id.* at 52 n.24.

[87]*Id.* at 51.

[88]*See* Kaiser Aetna v. United States, 444 U.S. at 192 (Blackmun, J., dissenting).

cies embodied in the concept of 'property.' "[89] This language bears a striking resemblance not only to the "reasonable expectations" mentioned in *Penn Central*, which were insufficient for claiming an interest in navigable waters,[90] but also to the "reasonable investment-backed expectancies" which the *Penn Central* Court considered a relevant factor in deciding whether governmental action constituted a taking. The extent of private investment, mentioned by the Court in *Penn Central* as a measure of government interference with property interests, is used here as a characteristic of ownership. A consideration of private investment in this context is more properly characterized by Justice Blackmun in his dissent as a "balance of interests on the question whether the exercise of the servitude in favor of public access requires compensation to private interests where private efforts are responsible for creating 'navigability in fact.' "[91]

Finally, the Court refused to apply the rule in *Chandler-Dunbar* that there can be no private ownership of a navigable body of water, stating that Kuapa Pond was not the sort of "great navigable stream" to which the rule applies.[92] This conclusion rests upon the finding that the pond was nonnavigable in its natural state. Although the pond was subject to the ebb and flow of the tides, and thus subject to regulation by the Corps of Engineers,[93] the Court refused to apply this "mechanical" test for the purpose of invoking navigational servitude.[94] The Court did not decide whether the new test for imposition of the servitude—natural navigability in fact—would, by itself, be enough.[95]

Having found that Kuapa Pond was private property, the Court easily resolved the taking issue. The creation of public access was not only a physical, governmental invasion of private property but also a deprivation of an essential incident of ownership—the right to exclude others.[96]

V. CONCLUSION

Kaiser Aetna represents an attempt to reconcile two contradictory legal principles. The first is that navigational servitude is, by

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[89]444 U.S. at 179.

[90]*See* text accompanying notes 80-83 *supra*.

[91]444 U.S. at 181 (Blackmun, J., dissenting).

[92]*Id.* at 178-79.

[93]*See* the Corps' definition of navigability at note 49 *supra*.

[94]444 U.S. at 178-79 n.10.

[95]*See id.* at 178 n.9.

[96]*Id.* at 179-80. By contrast, Justice Blackmun concluded that Kaiser Aetna had been allowed to appropriate navigable waters for private use. *Id.* at 191 (Blackmun, J., dissenting).

definition, an absolute right of public access to navigable waters. The second is that the government may not take private property for public use without just compensation. The Court solved its dilemma by redefining navigability in terms of the purpose of the definition. For the purpose of invoking navigational servitude, the term "navigable" applies, after *Kaiser Aetna*, only to a body of water navigable in fact in its natural state. Public navigational and fishing rights do not automatically arise when water becomes navigable by artificial means. Thus, in *Vaughn v. Vermilion Corp.*,[97] a companion case to *Kaiser Aetna*, the Court denied a public right of access to a system of navigable canals that had been artificially created with private funds.[98]

Regulatory authority over navigable waters is apparently unchanged by *Kaiser Aetna* and remains as broad as the needs of commerce.[99] Still undecided is the point at which the regulation becomes a taking. In the past, the Court has cited cases defining navigability without distinguishing between admiralty, federal title, and commerce clause cases, and, as one critic noted, often without realizing the difference.[100] The Court must now use the term with more precision so that cases involving navigation will not become, like the taking cases, a series of "ad hoc, factual inquiries."[101]

JOAN M. RUHTENBERG

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[97]444 U.S. 206 (1979).

[98]*Id.* 208-10.

[99]*See* note 28 *supra.*

[100]MacGrady, *supra* note 2, at 587 n.401.

[101]Penn Central Transp. Co. v. New York City, 438 U.S. at 124, *cited in* Kaiser Aetna v. United States, 444 U.S. at 174-75.

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